

1986

Financial Plan

And

Capital Requirements

OUTLINE

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OPENING REMARKS

LADIES AND GENTLEMEN:

IT IS A PLEASURE TO BE HERE WITH YOU THIS MORNING. I WOULD LIKE TO THANK EACH ONE OF YOU FOR YOUR CONTINUING SUPPORT. ALTHOUGH WE STILL HAVE SEVERAL HURDLES, WE FEEL WE HAVE MADE GOOD PROGRESS TOWARDS MEETING OUR FINANCIAL OBJECTIVES AND ARE ON SCHEDULE. IMPORTANTLY, AS WE AGREED AT THE TIME OF YOUR WAIVER EXTENSION LAST FALL, WE MET OUR COMMITMENT AND MADE SIGNIFICANT DEBT REDUCTIONS.

FOR THE PAST TWO MONTHS WE HAVE BEEN WORKING CLOSELY WITH OUR FINANCIAL ADVISORS, DILLON, READ AND COMPANY, ON THE FINANCIAL PLAN FOR CALENDAR 1986. AS YOU WILL SEE IN THIS PRESENTATION, WE HAVE PREPARED A FORECAST WHICH WE BELIEVE IS CONSERVATIVE AND ATTAINABLE, AFTER TAKING INTO CONSIDERATION THE POTENTIAL BUSINESS RISKS.

WITH REGARD TO OUR AGENDA THIS MORNING CLIVE SMITH, VICE PRESIDENT OF PLANNING, WILL OPEN THE PRESENTATION BY COVERING THE WORLDWIDE PERSONAL COMPUTER MARKET AND COMMODORE'S VOLUME AND MARKET SHARE. AFTER CLIVE, JOHN KELLY, VICE PRESIDENT OF FINANCE, WILL REVIEW UNIT PROFITABILITY, OPERATING RESULTS AND CASH FLOW. NEXT, TOM RATTIGAN, PRESIDENT AND CHIEF OPERATING OFFICER, WILL REVIEW OUR DECEMBER 1985 QUARTER, QUARTERLY FORECAST RESULTS FOR 1986 AND THE LONG-TERM OUTLOOK. AFTER TOM'S DISCUSSION, JOHN KELLY WILL THEN CONCLUDE THE PRESENTATION WITH A DISCUSSION OF OUR FINANCIAL POSITION AND FUTURE CREDIT REQUIREMENTS.

PAGE 2

DILLON READ HAS GIVEN US INVALUABLE ASSISTANCE IN EVALUATING ALTERNATIVE FINANCING STRATEGIES AND FORMULATING OUR CREDIT REQUEST. MEHDI ALI AND BOB BYRNE FROM DILLON READ ARE HERE WITH US TODAY.

IN AUGUST, WE PLAN TO HAVE ANOTHER BANK MEETING TO REVIEW OUR SIX MONTH PERFORMANCE VERSUS THE PLAN WHICH WE ARE ABOUT TO DISCUSS WITH YOU.

NOW CLIVE SMITH WILL BEGIN THE PRESENTATION.

Competitive Product Analysis

Product	Competitive Strength	Competitive Weakness
C64	Largest Installed Base Large Software Base (4000+ Titles) Largest Distribution in World Price Leader Easy to Use	Game Computer Image Lacks 80 Columns
C128	C64 Compatible Enhanced Features Low Cost Peripherals	Limited 80-Column Software Still Establishing Product Identity
PC10	Price Leader Brand Recognition Full PC-DOS Software Compatibility	Establishing Distribution Channel
AMIGA 512K	Multi-Tasking Superior Graphics and Sound Open Architecture	Lacks Software Base Still Establishing Product Identity Lacks Vertical Market Infrastructure

Competitive Product Analysis

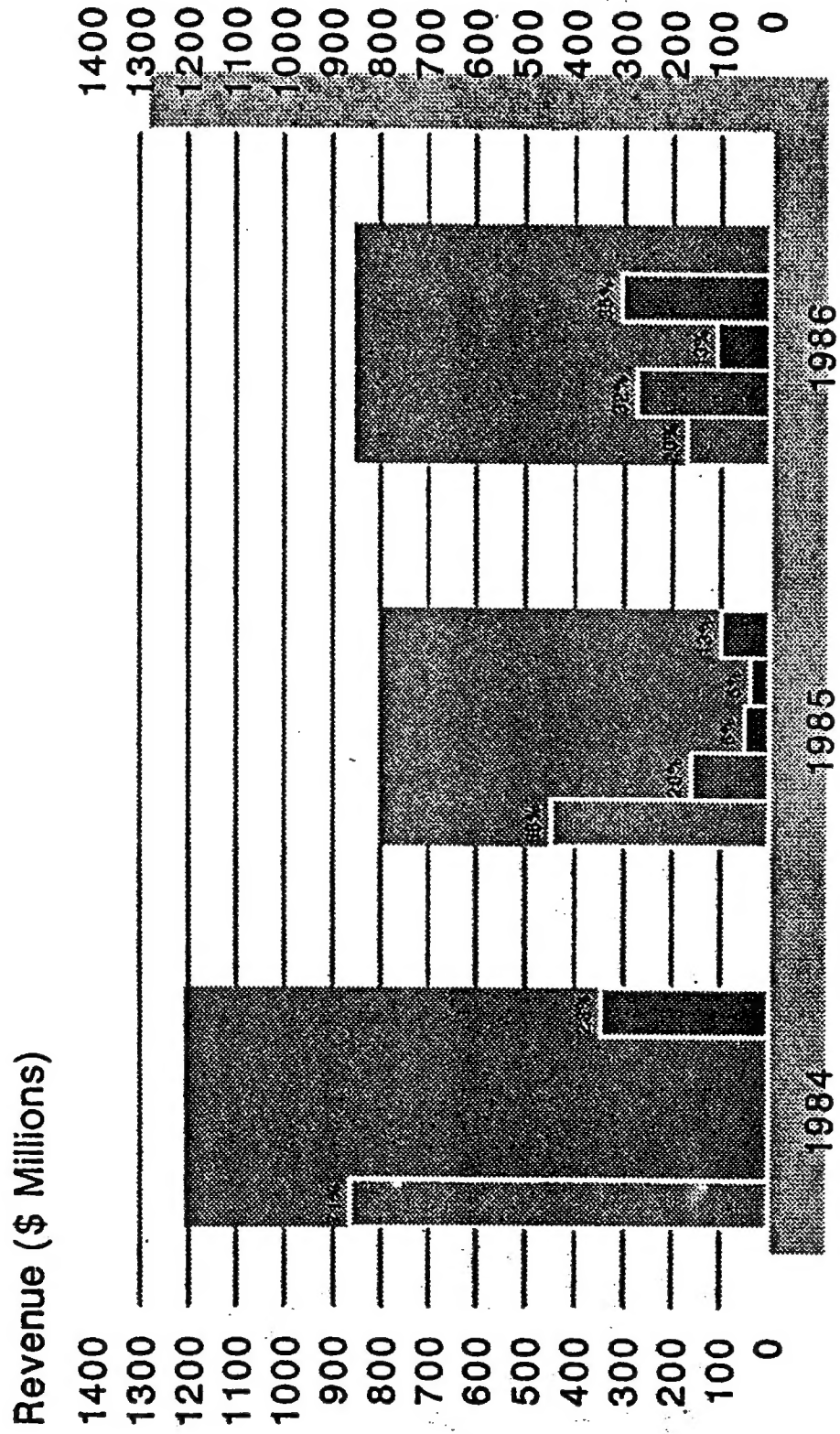
System Price
(CPU, Disk Drive,
Color Monitor)

Product Target Users System Price Competitive Product System Price Relative Price Index

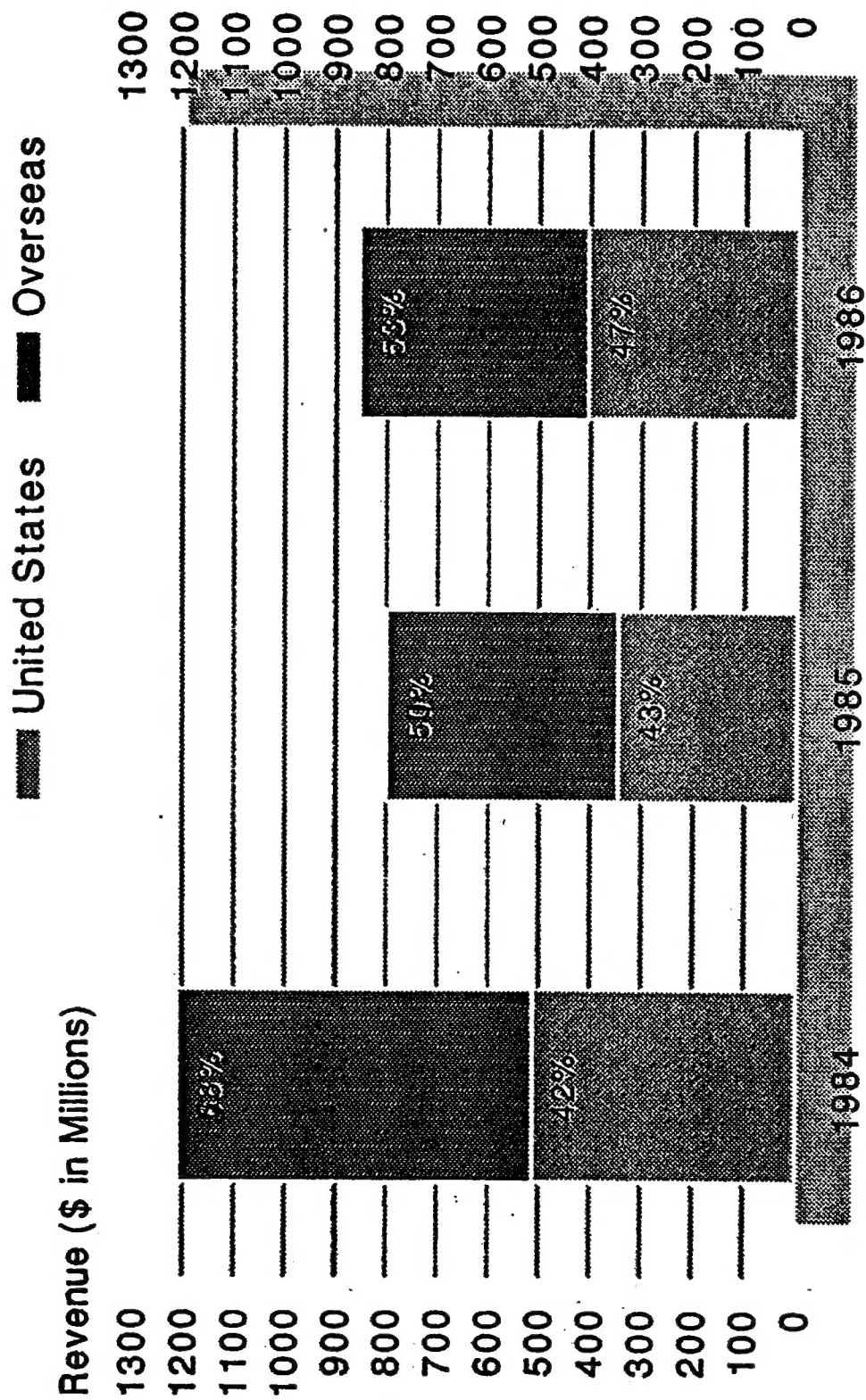
C64	None Education (K-12)	\$ 499	Apple II C	\$ 995	59%
C128	Home Education (K-12)	\$ 750	Atari 520ST Apple II E Amstrad	\$ 799 \$ 1100 \$ 650	95% 70% 115%
PC10	Home Education Business	\$ 1149	Tandy 1000 IBM PC Leading Edge	\$ 1295 \$ 1995 \$ 1495	90% 59% 77%
AMIGA 512K	Home Education Business	\$ 1995	Macintosh 512K MacPlus Atari 1040	\$ 1995 \$ 2595 \$ 1195	100% 75% 165%

Revenues

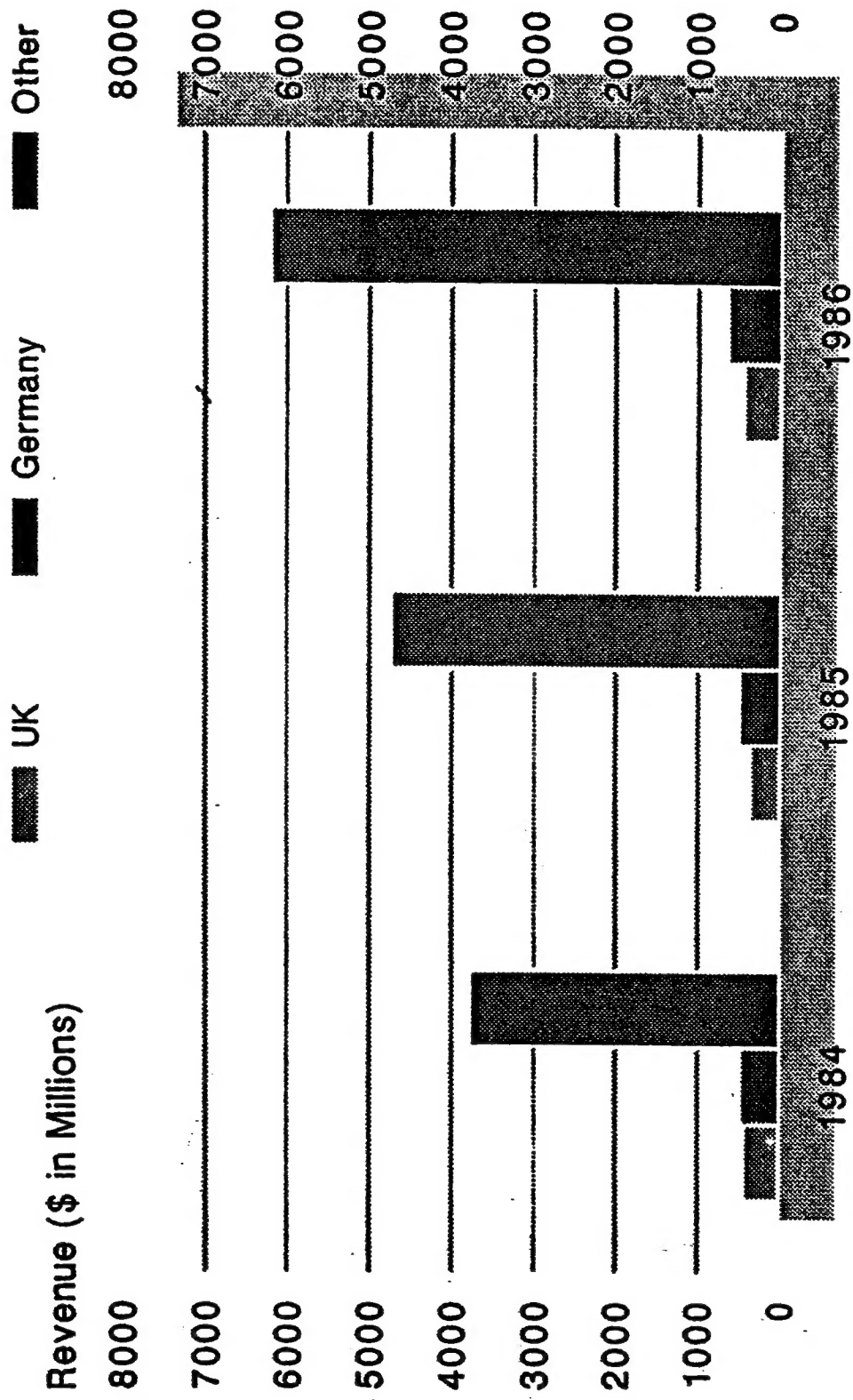
■ C64 ■ C128 ■ PC ■ Amiga ■ Other



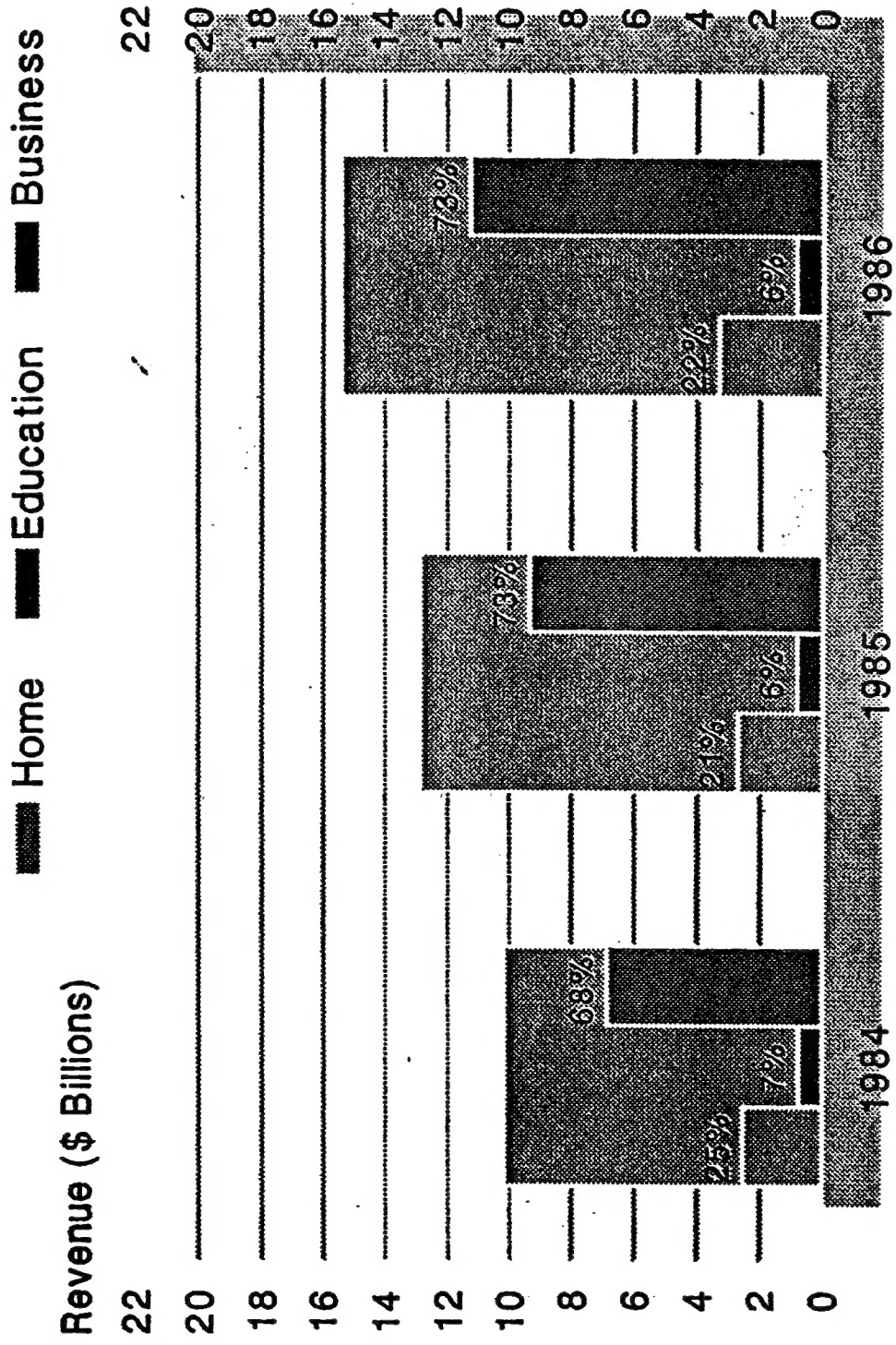
Revenues



PC Market - Overseas

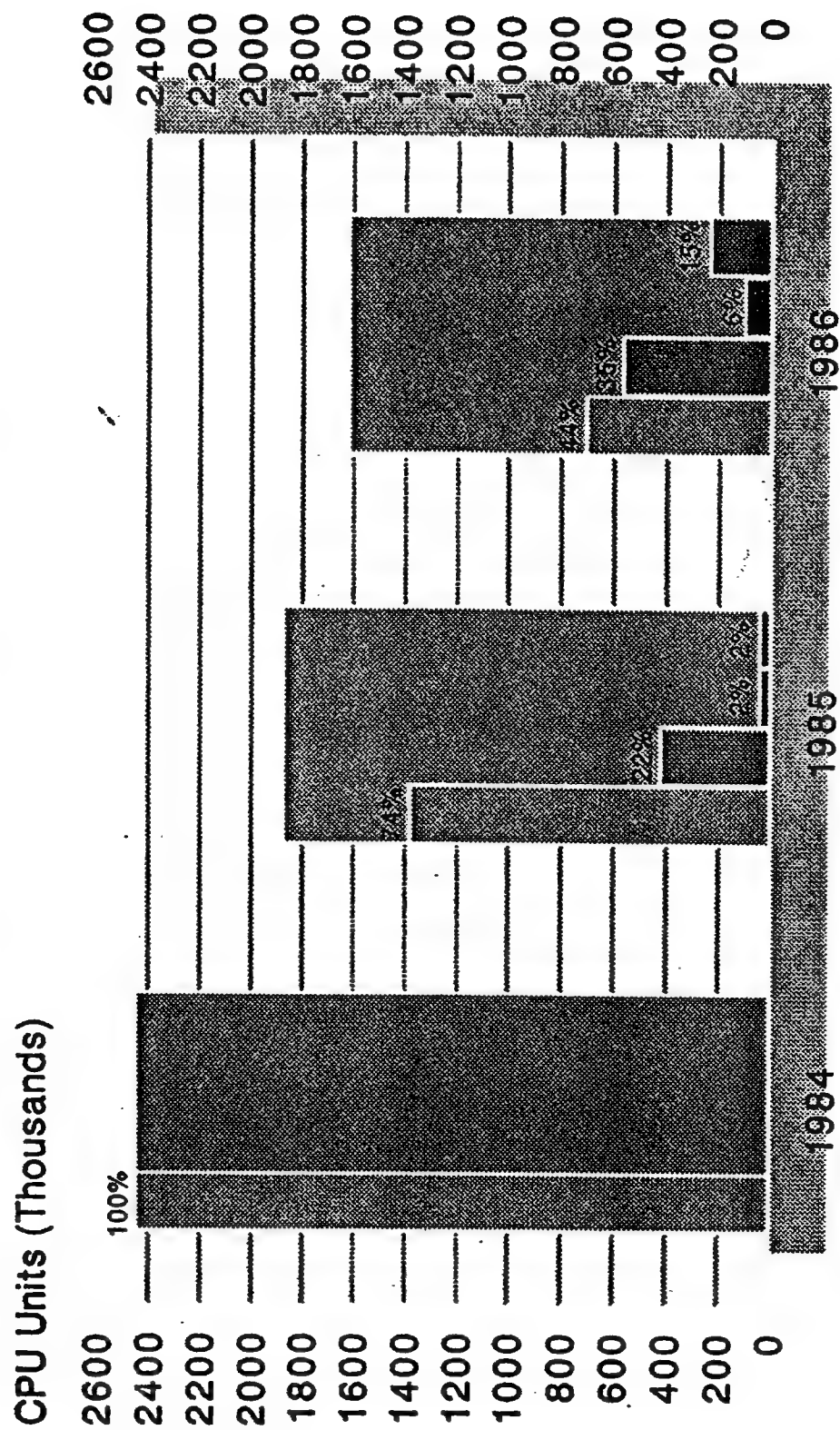


PC Market - United States

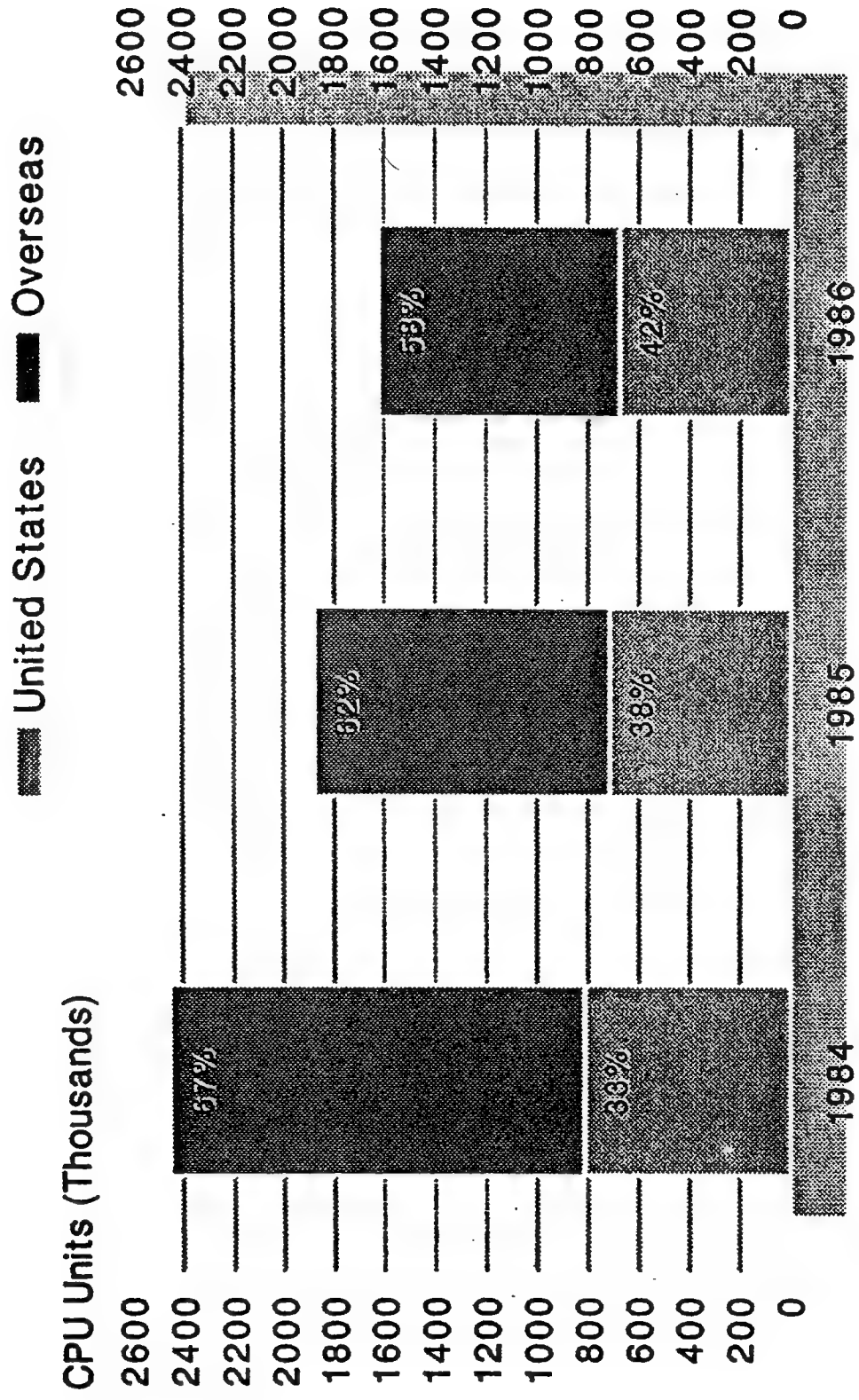


Unit Sales Volume

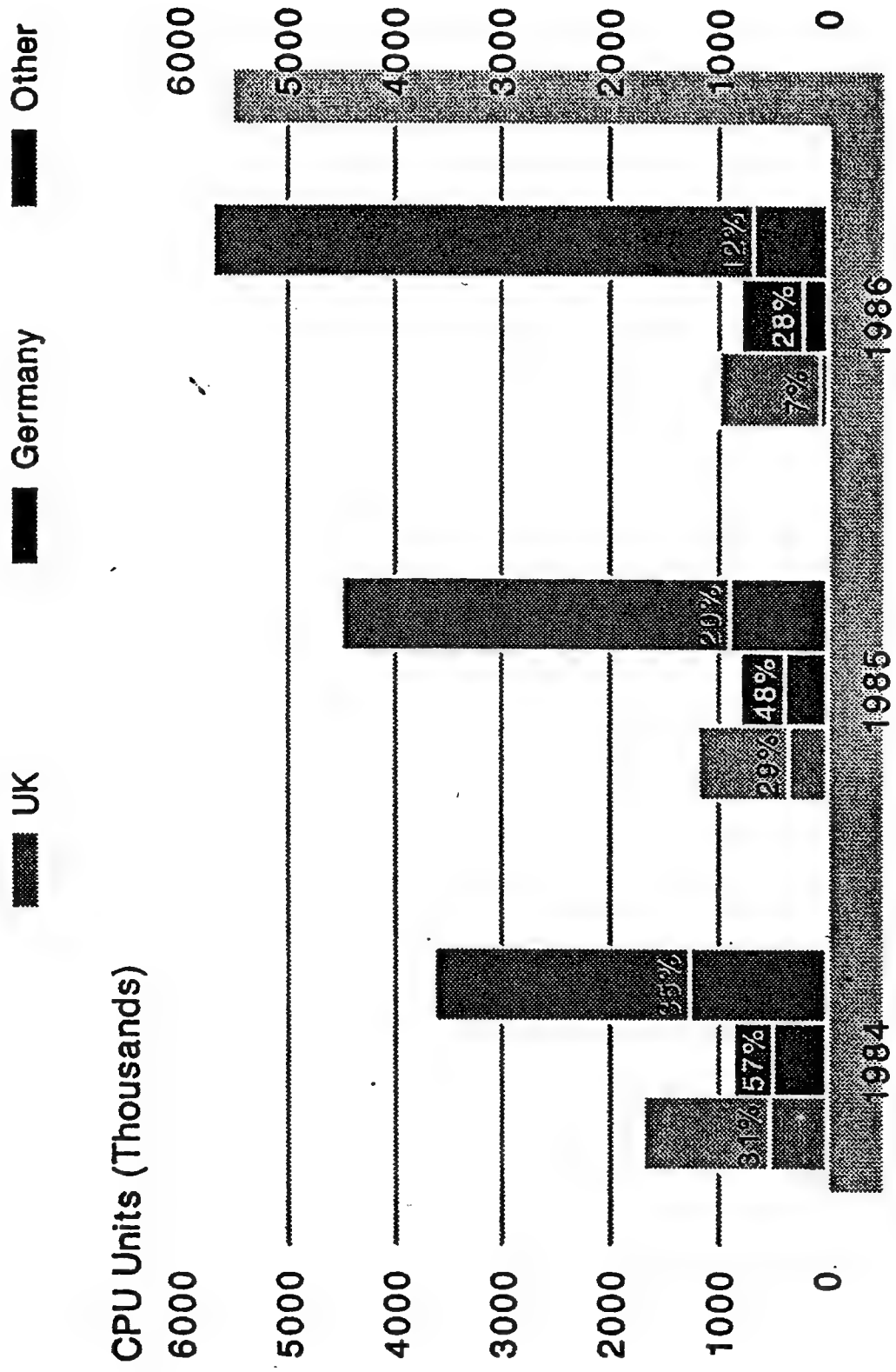
■ C64 ■ C128 ■ PC ■ Amiga



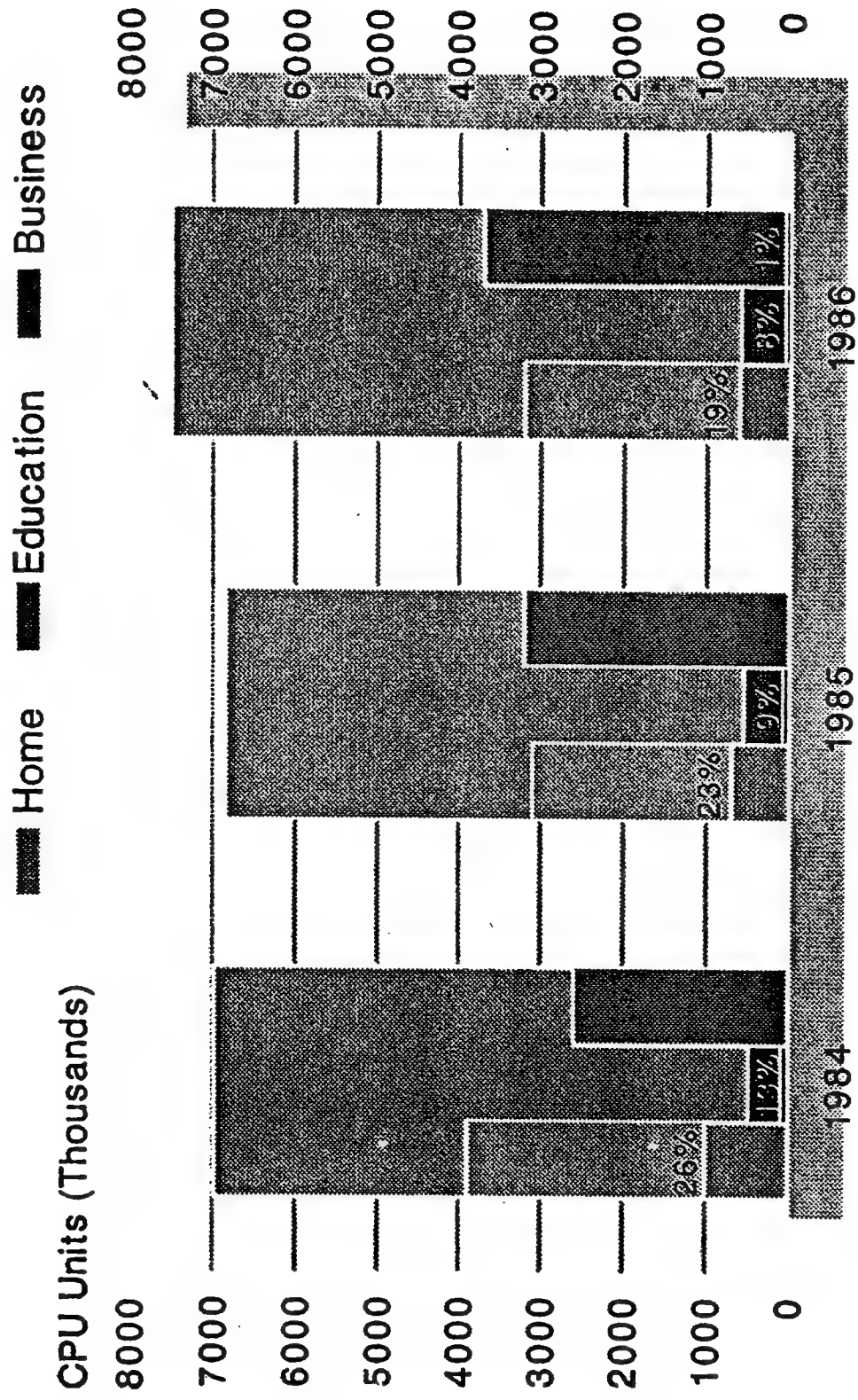
Unit Sales Volume



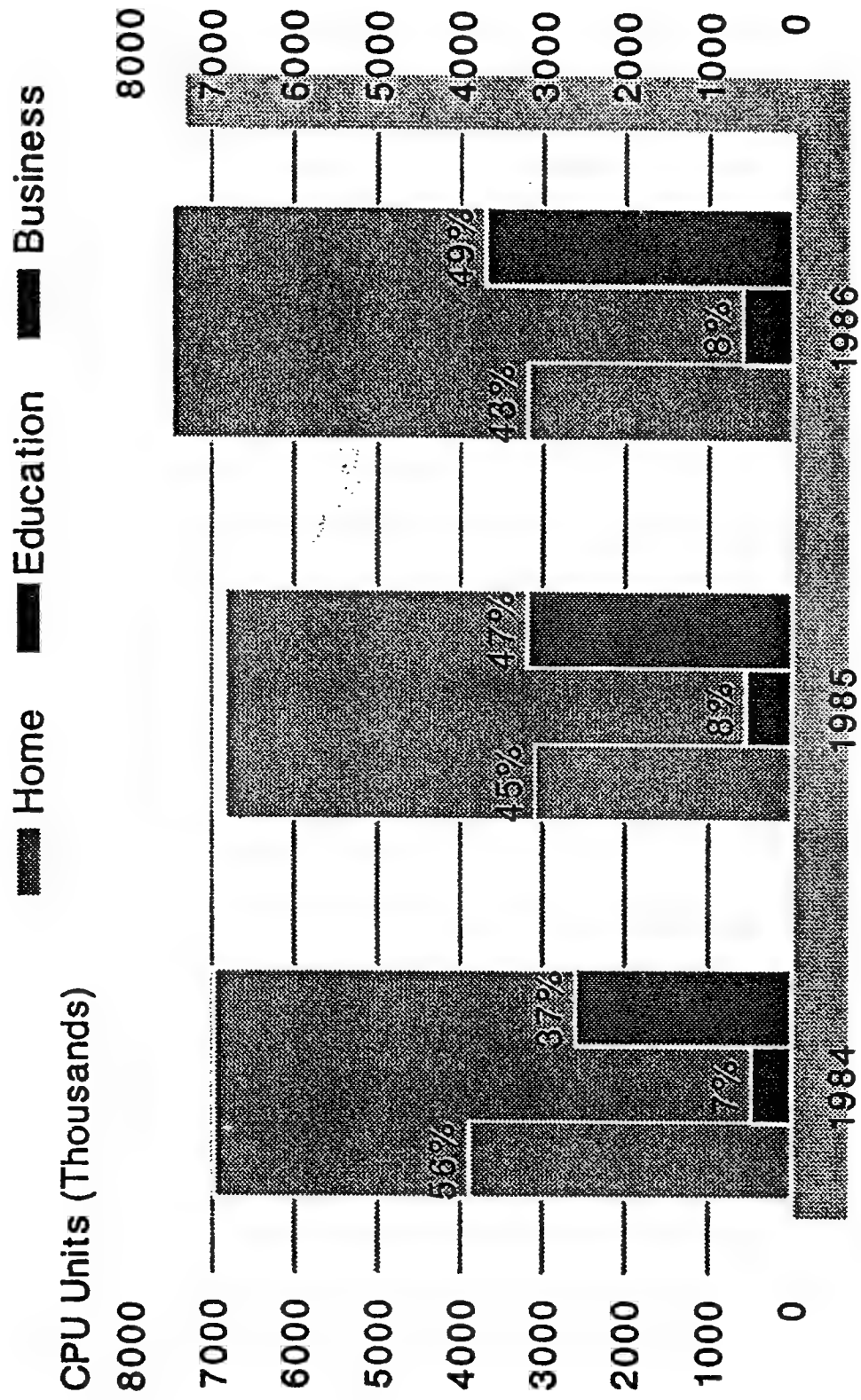
PC Market - Overseas



PC Market - United States



PC Market - United States



PC Market - Worldwide

	<u>1984</u>	<u>1985</u>	<u>1986</u>
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Unit Volume (000's)

United States	6,980	6,850	7,500
Overseas	6,200	6,500	7,500
Total	<u>13,180</u>	<u>13,350</u>	<u>15,000</u>

Revenues (\$MM)

United States	\$10,160	\$12,865	\$15,400
Overseas	4,715	5,600	7,300
Total	<u>\$14,875</u>	<u>\$18,465</u>	<u>\$22,700</u>

SLIDE 1 - SLIDE LEFT

IN ASSESSING THE "STATE OF THE PERSONAL COMPUTER MARKET". WE BEGIN WITH A GLOBAL OVERVIEW. ALL NUMBERS ARE PRESENTED ON A CALENDAR BASIS. MEASURED IN BOTH UNIT VOLUME AND REVENUES, THE WORLDWIDE PC MARKET CONTINUES TO SHOW STRONG POTENTIAL. BASED ON ESTIMATES FROM MARKET RESEARCHERS, UNIT SALES AND REVENUES ARE PROJECTED TO CONTINUE THE GROWTH OF THE PAST YEARS. ALTHOUGH UNIT SALES IN 1985 WERE ESSENTIALLY FLAT FROM 1984, THE GROWTH IN THE OVERSEAS MARKET OFFSET THE MARGINAL DECLINE IN THE U.S. IN 1986, WORLDWIDE UNIT VOLUME IS EXPECTED TO GROW BY 12%. IN REVENUES, THE PC MARKET IS EXPECTED TO EXPERIENCE EVEN GREATER GROWTH OF OVER 20% DURING 1986.

THE OVERSEAS MARKET IS EXPECTED TO EXPERIENCE MORE RAPID GROWTH THAN THE U.S. MARKET, AND IN UNIT TERMS IS FORECAST TO BE THE SAME SIZE AS THE U.S. MARKET BY 1986, UP ~~FROM~~^{FROM} 90% IN 1984. MEASURED IN REVENUES, THE OVERSEAS MARKET IS PROJECTED TO GROW BY 30% IN 1986, 10% FASTER THAN THE U.S. MARKET. COMMODORE'S BALANCED GLOBAL PRESENCE POSITIONS IT TO BENEFIT MORE FAVORABLY FROM THESE FORECAST DEVELOPMENTS THAN ITS MAJOR COMPETITORS. FOR EXAMPLE, COMMODORE DERIVES OVER HALF OF ITS REVENUES FROM OVERSEAS OPERATIONS COMPARED TO ABOUT 20% FOR APPLE AND 10% FOR TANDY. THIS PRESENCE REPRESENTS A SIGNIFICANT COMPETITIVE STRENGTH IN ENABLING COMMODORE TO PARTICIPATE STRONGLY IN THE FASTEST GROWING PC MARKETS. IN ADDITION TO GROWTH POTENTIAL, THERE ARE FUNDAMENTAL DIFFERENCES IN PRODUCT NEEDS BETWEEN THE U.S. AND OVERSEAS MARKETS WHICH BENEFIT COMMODORE'S PRODUCT STRATEGY. ALTHOUGH THE MARKETS ARE EXPECTED TO BE EQUAL IN UNITS, OVERSEAS REVENUES ARE FORECAST AT LESS THAN HALF OF THE U.S. THIS REFLECTS THE GREATER DEMAND FOR "ENTRY-LEVEL" PRODUCT OVERSEAS WHERE INCOME LEVELS AND STANDARDS-OF-LIVING ARE LOWER. COMMODORE'S CURRENT PRODUCT LINE EFFECTIVELY BRIDGES THE DIFFERENTIAL NEEDS BETWEEN THE TWO MARKETS. IN EASTERN EUROPE AND DEVELOPING COUNTRIES, FOR EXAMPLE, THE C64 AND C128 ARE SOLD

PRIMARILY AS BUSINESS COMPUTERS, WHILE IN THE U.S. AND WESTERN EUROPE, THESE PRODUCTS ARE PREDOMINANTLY SOLD IN THE RESIDENTIAL AND EDUCATIONAL SECTORS. CONVERSELY, THE AMIGA AND COMMODORE PC'S ARE POWERFUL, VERSATILE COMPUTERS WHICH ARE TARGETED FOR THE SOPHISTICATED CONSUMER, COLLEGE, AND BUSINESS MARKETS WORDWIDE.

SLIDE 2 - LEFT

ON CLOSER ANALYSIS, THE PC MARKET CAN BE DIVIDED INTO THREE DISTINCT SEGMENTS: 1) HOME, 2) EDUCATION, 3) BUSINESS. THIS SLIDE SHOWS THE ABSOLUTE AND RELATIVE SIZES OF THE PC^C MARKET SEGMENTS IN THE UNITED STATES, MEASURED IN TERMS OF CPU UNITS. THESE U.S. MARKET ESTIMATES ARE BASED ON AN AVERAGING OF DATA FROM LEADING INDEPENDENT MARKET RESEARCH FIRMS INCLUDING FUTURE COMPUTING, INFOCORP, AND YANKEE GROUP.

HISTORICALLY, THE HOME OR RESIDENTIAL SEGMENT HAS ACCOUNTED FOR THE LARGEST UNIT VOLUME IN THE INDUSTRY, AND INCLUDES BUSINESS-FROM-HOME AND WORK-AT-HOME BUYERS, AS WELL AS EDUCATIONAL/ENTERTAINMENT PURCHASES FOR CHILDREN. THE DEVELOPMENT OF THE RESIDENTIAL SEGMENT HAS BEEN EXTREMELY DISORDERLY. IN 1984, IT ACCOUNTED FOR 3.9 MILLION UNITS, OR ABOUT 56% OF ALL PC SALES IN THAT YEAR. IN 1985, THIS SEGMENT CONTRACTED DRAMATICALLY, DECLINING BY 20% TO APPROXIMATELY 3.1 MILLION UNITS, OR LESS THAN 1/2 OF ALL PC UNITS. CONTRIBUTING TO THIS DECLINE WAS THE PRICE WAR OF 1983 AND THE RESULTANT SHAKE-OUT IN THE MARKET, INCLUDING THE WITHDRAWAL OF MAJOR VENDORS SUCH AS TEXAS INSTRUMENTS AND TIMEX, NEGATIVE PUBLICITY, AND A GLUT OF LOW-PRICED DISCONTINUED PRODUCTS.

INDEPENDENT PROJECTIONS FOR THE 1986 RESIDENTIAL MARKET VARY CONSIDERABLY, RANGING BETWEEN 5 AND 15 PERCENT GROWTH OVER 1985. EVEN THOUGH THE NEGATIVE FACTORS JUST MENTIONED NO LONGER EXIST, IN THE INTEREST OF CONSERVATISM, COMMODORE IS PROJECTING THAT THE U.S. RESIDENTIAL MARKET WILL BE ESSENTIALLY FLAT IN 1986, AT 3.2 MILLION UNITS.

HOWEVER, DESPITE THE DECLINE IN RESIDENTIAL COMPUTER SALES, COMPUTERS IN THE HOME ARE NEITHER A FAD NOT A PHENOMENON LIMITED TO HOBBYIST AND AFFLUENT FAMILIES. HOUSEHOLD PENETRATION IN THE U.S. IS ABOUT 10 PERCENT, WHILE IN THE U.K. IT IS ALREADY OVER

27 PERCENT AND CLIMBING. WE BELIEVE THAT THIS BODES WELL FOR THE GROWTH OF THIS SEGMENT IN THE U.S. THE MOST IMPORTANT FACTOR DRIVING LONG-TERM RESIDENTIAL DEMAND IS EXPOSURE TO COMPUTERS AT SCHOOL ~~ARE~~ AT WORK, AND BOTH THESE SECTORS ARE GROWING RAPIDLY.
OK

THE EDUCATION MARKET IS CURRENTLY THE SMALLEST SEGMENT OF THE PC MARKET, ACCOUNTING FOR ONLY 550,000 UNITS, IN 1985. THE BUSINESS SEGMENT IS CURRENTLY THE LARGEST AND FASTEST GROWING AND ACCOUNTED FOR 3.2 MILLION UNITS IN 1985. IT IS FORECAST TO GROW 16% IN 1986 TO 3.7 MILLION UNITS, OR ABOUT ONE-HALF OF THE TOTAL U.S. PC MARKET.

SLIDE 3 - LEFT

THIS SLIDE SHOWS COMMODORE'S MARKET SHARE BASED ON ACTUAL UNIT SHIPMENTS AND OVERALL MARKET ESTIMATES PROVIDED BY THE LEADING MARKET RESEARCH FIRMS.

IN 1985, COMMODORE'S SHARE OF THE TOTAL PC MARKET DECLINED FROM 15% TO 11%, AND THE RESIDENTIAL MARKET SHARE DECLINED FROM 26% TO 23%. COMMODORE'S 1985 PERFORMANCE WAS BURDENED BY THE INTRODUCTION OF THREE NEW COMPUTERS--THE C128, THE AMIGA, AND THE PC 10/20--AND BY AN INVENTORY SHORTAGE OF OVER 100,000 UNITS OF THE C64. NOW THAT ^{WE}_A ARE PAST THE LAUNCH HURDLES, THE NEW PRODUCT LINES SHOULD CONTRIBUTE SIGNIFICANTLY TO VOLUME. INITIAL RESPONSE TO THE C128 HAS BEEN VERY STRONG. DURING ITS FIRST FOUR MONTHS, 420,000 UNITS WERE SOLD ESTABLISHING A RECORD LEVEL OF SALES FOR A NEW COMPUTER INTRODUCTION.

IN 1986 THE COMPANY'S TOTAL MARKET SHARE IS PROJECTED TO FALL TO 9% AS OUR VOLUME FALLS IN AN EXPANDING MARKET. IT IS IMPORTANT TO STRESS THAT THESE NUMBERS REFLECT THE CONSERVATIVE FINANCIAL PLAN, WHICH ^{IS}_A SIGNIFICANTLY BELOW THE MARKETING PLAN. THE FINANCIAL PLAN ESPECIALLY UNDERSTATES LIKELY 1986 SALES OF C64'S WHICH AT THE END OF JANUARY WERE STILL BACKORDERED BY OVER 50,000 UNITS.

COMMODORE'S MARKET SHARE IN THE EDUCATIONAL SEGMENT FELL FROM 13% IN 1984 TO 9% IN 1985, PRIMARILY BECAUSE OF THE LACK OF A STRONG EDUCATIONAL PROGRAM. WE HAVE CONSERVATIVELY PROJECTED A FURTHER DECLINE IN MARKET SHARE IN 1986 TO 8%, BUT WE HOPE TO DO BETTER THAN THIS WITH AN AGGRESSIVE EDUCATIONAL PROGRAM THAT IS BEING IMPLEMENTED FOR THE KINDERGARTEN THROUGH (12) GRADE MARKET AND, FOR THE FIRST TIME, FOR THE COLLEGE MARKET WITH THE AMIGA.

COMMODORE'S SHARE OF THE BUSINESS MARKET HAS HISTORICALLY BEEN NEGLIGIBLE. ALTHOUGH THE FORECAST IN 1986 IS ONLY 1-3%, FOR THE FIRST TIME COMMODORE HAS PRODUCTS--THE AMIGA AND PC LINE--THAT MEET THE NEEDS OF BUSINESS CUSTOMERS AND A U.S. DISTRIBUTION CHANNEL CAPABLE OF REACHING THESE CUSTOMERS.

SLIDE 4 - LEFT

TURNING TO THE PC MARKET OVERSEAS, THIS CHART ILLUSTRATES THE ESTIMATED SIZE OF THE TOTAL MICROCOMPUTER MARKET IN THE U.K., GERMANY, AND ALL OTHER COUNTRIES. COMMODORE'S SHARE OF THESE MARKETS IS SHOWN BY THE LINES IN EACH OF THE BARS OF THE GRAPH.

JUST AS IN THE U.S., THE TOTAL PC MARKET IN THE U.K. AND GERMANY CONTRACTED IN 1984 AND 1985. AGAIN, MUCH OF THE DECLINE WAS IN THE RESIDENTIAL SEGMENT. UNLIKE THE U.S., HOWEVER, GROWTH IN THE BUSINESS SECTOR WAS NOT SUFFICIENT TO OFFSET THE RESIDENTIAL DECLINE. THE EDUCATIONAL MARKET IN THESE COUNTRIES, ALTHOUGH GROWING, IS NOT YET A SIGNIFICANT FACTOR.

THE U.K. MARKET HAS UNDERGONE SEVERE PRICING COMPETITION LED BY LOCAL MANUFACTURERS^{ERS} ACORN, SINCLAIR AND AMSTRAD IN THE RESIDENTIAL SECTOR. THE OVERALL MARKET DECLINED BY 30% IN 1985 AND IS EXPECTED TO FALL ANOTHER 17% IN 1986. COMMODORE'S SHARE OF THE U.K. MARKET FELL FROM 31% IN 1984 TO A PROJECTED 7% IN 1986. THIS SUBSTANTIAL DECLINE IS DUE PARTLY TO THE CONSERVATIVE NATURE OF OUR FORECASTS, AND PARTLY TO THE DISCONTINUANCE OF TED PRODUCTS. IF THE SALES OF THE TED PRODUCTS ARE EXCLUDED FROM THE SALES OF PRIOR YEARS, THE DECLINE IN U.K. MARKET SHARE IS FROM 18% IN 1984 TO 12% IN 1985 AND 7% IN 1986.

SLIDE 5 - LEFT

HERE YOU SEE COMMODORE'S WORLDWIDE UNIT SALES, EXCLUDING DISCONTINUED PRODUCTS SUCH AS THE VIC-20, AND TED PRODUCTS. 1984 SALES OF 2.4 MILLION UNITS WERE ATTRIBUTABLE ENTIRELY TO THE C64. IN 1985, TOTAL UNIT VOLUME DECREASED BY MORE THAN 20% TO 1.9 MILLION UNITS, DESPITE SALES OF APPROXIMATELY 500,000 UNITS OF NEW PRODUCTS SUCH AS THE C128, AMIGA AND COMMODORE PC 10 SYSTEMS. A CONTINUING SHIFT IN PRODUCT MIX IS EXPECTED TO HAVE A FAVORABLE IMPACT ON REVENUES, WHICH I WILL DISCUSS SHORTLY.

LOOKING FORWARD TO 1986, OVERALL UNIT VOLUME OF CONTINUING PRODUCT IS FORECAST TO DECLINE BY 14% TO 1.6 MILLION UNITS. THE FINANCIAL PROJECTION SHOWS A DECLINE OF 670,000 C64'S, WHICH SHOULD BE PARTIALLY OFFSET BY A 420,000 UNIT INCREASE IN AMIGA AND C128 SALES.

NON-U.S. SALES ACCOUNTED FOR NEARLY 67% OF COMMODORE'S UNIT VOLUME IN 1984 AND ARE PROJECTED TO ACCOUNT FOR 58% OF TOTAL UNITS IN 1986. ACCORDINGLY, U.S. SALES WILL RISE FROM 33% IN 1984 TO 42% OF TOTAL UNITS THIS YEAR.

SLIDE 6 - LEFT

LOOKING AT COMMODORE'S WORLDWIDE UNIT SALES FOR THE CURRENT PRODUCT LINE, IT SHOULD BE NOTED THAT THE NEW PRODUCTS INTRODUCED IN MID-1985 WILL HAVE A PROFOUND IMPACT ON THE UNIT SALES MIX FOR 1986 AND BEYOND. MOST SIGNIFICANTLY, DEPENDENCY ON THE C64 IS PROJECTED TO DIMINISH DRAMATICALLY TO 44% OF UNIT SALES IN 1986, DOWN FROM 74% IN 1985.

THE C128 ACCOUNTED FOR 22% OF UNIT SALES IN 1985 AND IS FORECAST TO ACCOUNT FOR 35% IN 1986. ADDITIONALLY, WITH SOFTWARE AVAILABILITY EXPECTED TO INCREASE THROUGHOUT THE FIRST HALF OF 1986, AMIGA SALES SHOULD ACCELERATE AND ACCOUNT FOR 15% OF TOTAL UNIT SALES IN 1986.

TURNING TO A MORE DETAILED REVIEW OF THE VOLUME OUTLOOK, COMMODORE'S FINANCIAL FORECAST FOR 1986 IS BASED ON THE EXTREMELY CONSERVATIVE ASSUMPTION THAT UNIT SALES OF THE C64 WILL DECLINE BY 50% OVER 1984, TO APPROXIMATELY 700,000 UNITS ON A WORLDWIDE BASIS. AS IN THE PAST TWO YEARS, COMMODORE EXPECTS TO SELL ONE-THIRD OF THE ENTIRE C64 VOLUME IN THE U.S. (OR 235,000 UNITS) AND THE REMAINING TWO-THIRDS IN THE OVERSEAS MARKET.

THERE ARE SEVERAL FACTORS INDICATING THAT SALES OF THE C64 HAVE SIGNIFICANT UPSIDE POTENTIAL BEYOND THE 700,000 UNITS PROJECTED BY THE FINANCIAL PLAN. THESE FACTORS INCLUDE SALES AND BACKORDER LEVELS THAT ARE AHEAD OF FORECAST, AS WELL AS A SERIES OF PLANNED PRODUCT ENHANCEMENTS.

THE C128 TARGET MARKET IS ESSENTIALLY THE MORE AFFLUENT C64 BUYER WHO NEEDS AN UPGRADED PRODUCT, AND COMMODORE EXPECTED THE MAJORITY OF EARLY SALES TO COME FROM EXISTING C64 OWNERS. ALTHOUGH THIS HAS OCCURRED, THE C128 HAS ALSO ATTRACTED FIRST-TIME BUYERS WHOSE NEEDS ARE PRIMARILY BUSINESS/PRODUCTIVITY ORIENTED. WARRANTY CARD SURVEYS REVEAL THAT NEARLY 50% OF C128 SALES IN 1985 WERE TO FIRST TIME BUYERS, A TREND THAT APPEARS TO BE ACCELERATING.

I-8

WHILE SOME CANNIBALIZATION OF C64 SALES IS EXPECTED TO OCCUR, THE C128 SALES RESEARCH INDICATES THAT COMMODORE IS BEING SUCCESSFUL IN REACHING DIFFERENT BUYERS AT A HIGHER PRICE-POINT AND INCREASING COMMODORE'S MARKET COVERAGE.

OF THE THREE COMPUTERS INTRODUCED IN 1985, THE AMIGA OFFERS THE GREATEST LONG-TERM POTENTIAL AND IS THE MOST CRITICAL TO THE VIABILITY OF COMMODORE. EXCEPTIONAL FUNCTIONALITY, INCLUDING MULTI-TASKING, SPECIAL GRAPHICS, ANIMATION AND MUSICAL CAPABILITIES DISTINGUISH THE AMIGA AS A PRODUCT THAT CAN SPAN ALL THREE MARKET SEGMENTS - HOME, EDUCATION AND BUSINESS. COMMODORE'S WORLDWIDE SALES FORECAST OF 240,000 AMIGAS IN 1986 - 175,000 UNITS IN THE U.S. AND 65,000 OVERSEAS, IS BASED PRIMARILY ON THE SUPERIOR PRICE/PERFORMANCE OF THE PRODUCT. AS A MEASURE OF THE CONSERVATISM OF THIS FORECAST, THE VOLUME OF 175,000 UNITS IN THE U.S. WOULD ACCOUNT FOR ONLY 6% OF THE TOTAL HOME MARKET IN 1986. IT WOULD BE AN EVEN SMALLER PERCENTAGE IF EXPECTED SALES TO THE EDUCATIONAL AND BUSINESS MARKETS ARE FACTORED IN.

INITIAL REVIEWS OF THE AMIGA HAVE BEEN VERY FAVORABLE, AND THE COMPANY HAS ESTABLISHED A REASONABLY STRONG NORTH AMERICAN DISTRIBUTION BASE WITH OVER 800 SPECIALTY STORES CARRYING THE PRODUCT. IT IS EXPECTED THAT DISTRIBUTION WILL BE EXPANDED TO AT LEAST 1500 U.S. OUTLETS IN 1986, PLUS ABOUT 500 IN EUROPE. HOWEVER, SOFTWARE AVAILABILITY AND IBM COMPATIBILITY IS CRITICAL TO AMIGA'S SUCCESS. SLUGGISH SALES DURING THE DECEMBER QUARTER OF 25,000 UNITS WERE DUE TO THE AVAILABILITY OF ONLY 15 SOFTWARE PROGRAMS AT YEAR-END 1985. CURRENTLY, 52 TITLES ARE AVAILABLE THROUGH RETAIL OUTLETS AND THE COMPANY IS TAKING A NUMBER OF STEPS TO ENSURE THAT QUALITY SOFTWARE, ESPECIALLY BUSINESS SOFTWARE, WILL BE ON THE SHELVES BY SPRING OF 1986. IT IS CONSERVATIVELY EXPECTED THAT AN ADDITIONAL 65-75 TITLES WILL BE AVAILABLE BY THE END OF THE FIRST QUARTER, AND AN ESTIMATED 200 TITLES GOING INTO THE FALL. MOST IMPORTANTLY, COMMODORE HAS BEEN

CLOSELY MONITORING THE DEVELOPMENT OF SOFTWARE IN 5 KEY AREAS: WORD PROCESSING, SPREADSHEETS, DATA BASE MANAGEMENT, TELECOMMUNICATIONS AND GRAPHICS. ALL OF THESE ARE EXPECTED TO BE AVAILABLE BY THE END OF APRIL, AND SUPERIOR SOFTWARE IN EACH CATEGORY REPRESENTING PROGRAMS EQUIVALENT TO THOSE OF THE MOST POPULAR VENDORS WILL BE AVAILABLE BY THE END OF JUNE. ADVANCED NEGOTIATIONS ARE CURRENTLY UNDERWAY WITH MICROSOFT TO TRANSFER KEY SOFTWARE TITLES TO THE AMIGA.

SLIDE 7 - LEFT

LET US NOW EXAMINE THE U.S. PC MARKET IN TERMS OF THE DOLLAR VALUE OF SALES. AS NOTED EARLIER, ALTHOUGH TOTAL UNIT VOLUME DECLINED IN 1985, TOTAL WHOLESALE REVENUES ACTUALLY INCREASED 27% TO \$12.9 BILLION IN 1985. A FURTHER 20% INCREASE TO \$15.4 BILLION IS FORECAST FOR 1986.

EVEN THE RESIDENTIAL SEGMENT, WHILE RECORDING A 20% UNIT DECLINE IN 1985, ACHIEVED A 7% REVENUE INCREASE FOR THE PERIOD, REFLECTING A CONSUMER SHIFT TOWARD MORE EXPENSIVE CPU'S AND SYSTEM SALES. IN 1986 THE RESIDENTIAL SEGMENT IS EXPECTED TO HOLD ITS SHARE AT ABOUT 22% OF TOTAL PC REVENUES IN 1986.

THE BUSINESS SEGMENT, WHICH HAS ALWAYS HELD THE DOMINANT REVENUE SHARE, HAS GROWN FROM 68% IN 1984 TO A 73% SHARE IN 1985, AND IS PROJECTED TO MAINTAIN THIS LEVEL IN 1986.

DUE TO COMMODORE'S PREVIOUSLY NOMINAL PARTICIPATION IN THE BUSINESS SEGMENT, THE COMPANY'S SHARE OF TOTAL MARKET REVENUES DECREASED FROM 5.0% IN 1984 TO ABOUT 3% IN 1985 AS THE BUSINESS MARKET HAS GROWN IN IMPORTANCE. DESPITE THE OVERALL UNIT DECLINE FROM 1985 DISCUSSED EARLIER, THE NEW, HIGHER PRICED COMMODORE PRODUCTS SHOULD AT LEAST MAINTAIN A 3% REVENUE SHARE IN 1986.

SIMILARLY, IN THE HOME SECTOR, COMMODORE SHOULD MAINTAIN ITS 12% REVENUE SHARE THIS YEAR.

SLIDE 8 - LEFT

THE OVERSEAS MARKETS FOLLOWED THE DOMINANT TRENDS EVIDENT IN THE U.S., MOVING AWAY FROM ENTRY LEVEL SYSTEMS TOWARD INCREASED PRICE AND FUNCTIONALITY. IN THESE MARKETS, THEREFORE, REVENUE TRENDS ALSO OUTPACED UNIT TRENDS IN 1984 AND 1985. IN THE U.K., FOR EXAMPLE, TOTAL 1985 UNITS DECLINED BY NEARLY 30% FROM 1984 WHILE DOLLAR REVENUE SLIPPED ONLY 17%. IN GERMANY, REVENUES ACTUALLY INCREASED 3% DESPITE AN 8% DROP IN UNITS.

DURING 1985, COMMODORE'S MARKET SHARE DECLINED TO 13% IN THE U.K. AND TO A 25% SHARE IN GERMANY COMPARED TO 23% AND 37% RESPECTIVELY IN 1984. THIS SHARE SLIPPAGE ACCOMPANIED THE MOVEMENT OF OBSOLETE INVENTORY AT PRICES APPROXIMATING COSTS. COMMODORE REVENUES FROM ALL OTHER OVERSEAS MARKETS DECREASED TO 6% IN 1985 FROM 11% IN 1984.

FOR THE CURRENT YEAR, OVERALL PC REVENUES ARE EXPECTED TO SHOW ABOUT 20% GROWTH IN THE U.K., 30% IN GERMANY, AND A COMPARABLE INCREASE IN ALL OTHER AREAS. AGAIN, THE IMPETUS WILL COME PRIMARILY FROM THE BUSINESS SEGMENT. IN 1986, ALTHOUGH COMMODORE ANTICIPATES A 6% DECLINE IN U.K. REVENUES, ~~IT IS~~ ^{WE} ARE PROJECTING AN 8% INCREASE IN GERMAN REVENUES, PRIMARILY AS A RESULT OF AMIGA AND COMMODORE PC SALES.

SLIDE 9 - LEFT

COMMODORE'S WORLDWIDE REVENUES REACHED A RECORD \$1.2 BILLION IN CALENDAR 1984 BUT DECLINED 33% IN CALENDAR 1985. FOR 1986, REVENUES ARE EXPECTED TO INCREASE 7.4% TO \$855 MILLION. ALTHOUGH THE PROJECTED DECLINE IN UNIT SALES FROM 1986 WOULD NORMALLY RESULT IN A REVENUE DECLINE OF NEARLY \$100 MILLION, THE EXPECTED SHIFT IN PRODUCT MIX FAVORING HIGHER-END PRODUCTS, LIKE THE AMIGA AND THE PC GROUP, CREATE A FAVORABLE PRICE VARIANCE OF NEARLY \$260 MILLION.

ALL OF THE GROWTH EXPECTED TO OCCUR IN REVENUES DURING 1986 WILL TAKE PLACE IN THE U.S. ^{WHERE} SALES SHOULD INCREASE 17.5% DURING 1986. AS A RESULT, THE U.S. IS EXPECTED TO ACCOUNT FOR 47% OF WORLDWIDE REVENUES IN 1986, UP FROM 43% ^{AND} ~~AS~~ 42% IN 1985 AND 1984, RESPECTIVELY. IN 1986, REVENUES FROM OVERSEAS OPERATIONS ARE PROJECTED TO REMAIN UNCHANGED AS THE PROJECTED 35% GROWTH IN REVENUE FROM EXISTING PRODUCTS IS EXPECTED TO BE OFFSET BY A DECLINE IN SALES OF DISCONTINUED PRODUCTS.

SLIDE 10 - LEFT

THE DIMINISHING IMPORTANCE OF C64 PRODUCTS IN THE FINANCIAL FORECAST IS READILY APPARENT WHEN LOOKING AT REVENUES BY PRODUCT. AS THE SALES MIX SHIFTS TOWARDS MORE EXPENSIVE PRODUCT LINES, THE C64 IS PROJECTED TO ACCOUNT FOR ONLY 20% OF TOTAL REVENUES IN 1986, DOWN FROM 56% IN 1985.

REVENUES FOR THE C128 GROUP ARE FORECAST TO ACCOUNT FOR NEARLY ONE-THIRD OF TOTAL REVENUES IN 1986, UP FROM 20% IN 1985. THIS GROWTH REFLECTS A FULL YEAR OF C128 SALES AND AN IMPROVEMENT IN PERIPHERAL PENETRATION.

AMIGA SALES ARE EXPECTED TO CONTRIBUTE THE LARGEST SHARE OF REVENUES IN 1986, ACCOUNTING FOR NEARLY 36% OF THE TOTAL. PERIPHERAL PENETRATION IS PARTICULARLY HIGH IN THE CASE OF THE AMIGA, WITH 75 TO 80% OF ALL UNITS EXPECTED TO BE SOLD WITH A MONITOR AND MEMORY EXPANSION CARD.

SLIDE 11 - LEFT

SLIDE 11 - RIGHT

THESE SLIDES PROVIDE AN ANALYSIS OF COMMODORE'S COMPETITIVE PRODUCT POSITION DURING 1986.

READING FROM LEFT TO RIGHT, YOU CAN SEE THAT COMMODORE'S EXTENDED PRODUCT LINE NOW HAS SEVERAL ENTRIES IN EACH OF THE MAJOR MARKET SEGMENTS. SYSTEM PRICING IN COLUMN 2 OF THIS SLIDE DOES NOT REFLECT PLANNED PRICING AND PROMOTIONAL MOVES IN MID-1986 THAT ARE BUILT INTO THE FINANCIAL PLAN. THESE PRICING ACTIONS WILL IMPROVE THE PRICE/PERFORMANCE OF COMMODORE'S PRODUCT LINE, AND ALLOW THE COMPANY TO REMAIN COMPETITIVE IN THE FACE OF LIKELY PRICING MOVES BY OUR MAJOR COMPETITORS. COMPETITIVE PRODUCTS AND PRICES ARE PROVIDED IN COLUMNS 4 AND 5. THE LAST COLUMN OF THE LEFT SIDE DEMONSTRATES COMMODORE'S PRICE LEADERSHIP IN EVERY CATEGORY AND AGAINST PRACTICALLY EVERY PRODUCT. THE CHART ON THE RIGHT REFLECTS THE STRENGTH AND WEAKNESS OF COMMODORE'S PRODUCTS.

COMMODORE'S IMAGE AND STRENGTH WORLDWIDE IS ITS GLOBAL LEADERSHIP IN THE ENTRY LEVEL HOME COMPUTER MARKET. WITH THE C64 RETAILING FOR APPROXIMATELY \$150, AN ENTIRE SYSTEM CONSISTING OF CPU, DISK DRIVE AND COLOR MONITOR CAN BE ASSEMBLED FOR LESS THAN \$500. A SYSTEM OF THE CLOSEST COMPETITOR, THE APPLE IIC, WOULD COST ROUGHLY TWICE AS MUCH. THE C64 HAS THE LARGEST INSTALLED BASE IN THE WORLD - 5 MILLION UNITS, ONE OF THE LARGEST SOFTWARE LIBRARIES (4,000-6,000 TITLES), THE BROADEST DISTRIBUTION OF ANY MICROCOMPUTER (20,000 PLUS OUTLETS WORLDWIDE), THE LOWEST PRICE OF ANY 64K COMPUTER IN MASS DISTRIBUTION, AND A SIGNIFICANT WORLDWIDE PRESENCE IN THE EDUCATIONAL MARKET. THESE INTANGIBLE ASSETS CONSTITUTE A MAJOR COMPETITIVE ADVANTAGE FOR COMMODORE AND A MAJOR BARRIER TO ENTRY FOR COMPETITORS.

THE MOST SIGNIFICANT COMPETITIVE WEAKNESS OF THE C64 IS ITS IMAGE AS A GAME COMPUTER. THE MACHINE CURRENTLY LACKS 80 COLUMNS AND IS NOT EXPANDABLE, LIMITING ITS FUNCTIONALITY FOR CERTAIN WORD PROCESSING AND BUSINESS APPLICATIONS. THE LAUNCH OF THE COMPATIBLE C128 PRODUCT OVERCOMES THESE SHORTCOMINGS, AND ~~AS PREVIOUSLY MENTIONED~~, SEVERAL DEVELOPMENTS DESIGNED TO IMPROVE THE IMAGE AND PERFORMANCE OF THE C64 ARE PLANNED FOR EARLY 1986. THESE ENHANCEMENTS WILL BE ADDRESSED IN THE PRODUCT STRATEGY DISCUSSION LATER IN THE PRESENTATION.

THE EXPANDABLE C128 ADDRESSES THE UPGRADED NEEDS OF THE MORE AFFLUENT MEMBERS OF THE CONSUMER AND EDUCATION MARKETS ALREADY SERVED BY THE C64. C64 COMPATIBILITY ALLOWS THE C128 TO BENEFIT FROM MOST OF THE STRENGTHS OF THE C64 WHILE MAKING UP FOR ITS DEFICIENCIES. THE C128 PROVIDES 80 COLUMNS, A NUMERIC KEYPAD AND A CONTEMPORARY DESIGN. LIKE THE C64, PERIPHERALS FOR THE C128 ARE INEXPENSIVE AND A SYSTEM COMPLETE WITH CPU, DISK DRIVE AND COLOR MONITOR RETAILS FOR APPROXIMATELY \$750. THE C128 SYSTEM SELLS AT A DISCOUNT TO COMPETITIVE PRODUCTS IN THE U.S., PRIMARILY APPLE IIE WHICH RETAILS AT \$1100 AND THE ATARI 520ST WHICH RETAILS FOR APPROXIMATELY \$800. HOWEVER, CONTINUING COST REDUCTION EFFORTS FOR THE C128 ARE ESSENTIAL, AS A COMPARABLE AMSTRAD SYSTEM COSTS \$650 OR APPROXIMATELY 15% LESS THAN THE C128 IN MARKETS SUCH AS GERMANY.

DESPITE ITS VERY SUCCESSFUL INTRODUCTION IN 1985, THE C128 IS STILL ESTABLISHING ITS PRODUCT IDENTITY AND AVAILABILITY OF 80 COLUMN SOFTWARE IS CURRENTLY LIMITED. FURTHER ENHANCEMENTS TO THE C128, SUCH AS ADDITIONAL MEMORY AND EXPANSION SLOTS, WILL BE IMPLEMENTED IN 1986 TO MAINTAIN PRODUCT DIFFERENTIATION FROM THE C64.

THE PC PRODUCT LINE, INTRODUCED INTO EUROPE IN 1985 TO COMPETE WITH IBM AND IBM-CLONES, QUICKLY ACHIEVED SUCCESS DUE TO PRICE LEADERSHIP, FAVORABLE REVIEWS AND STRONG COMPUTER STORE DISTRIBUTION. THE PC-10 COMPETES MOST DIRECTLY WITH THE IBM PC AND RETAILS AT \$1150, 40% LESS THAN THE IBM PC WHICH COSTS \$2,000. A COMMODORE PC WILL BE INTRODUCED INTO THE U.S. IN MID-1986 AND WILL OFFER SUPERIOR FEATURES AND BE LESS EXPENSIVE THAN THE SIMILARLY CONFIGURED IBM PC'S AND PC CLONES. THE SUCCESS OF THE PC LINE IN THE U.S. OBVIOUSLY DEPENDS ON ESTABLISHING A STRONG DISTRIBUTION CHANNEL.

THE AMIGA IS THE SINGLE MOST IMPORTANT PRODUCT TO THE LONG-TERM SUCCESS OF COMMODORE. WITH MEMORY EXPANSION TO 512K AND A COLOR MONITOR, AN AMIGA SYSTEM CURRENTLY RETAILS FOR APPROXIMATELY \$2,000, BUT ^{IS} PROJECTED TO BE IN THE \$1,500-\$1,600 RANGE BY THE FALL.

THE MAJOR IMPEDIMENT TO AMIGA SALES PRESENTLY IS THE LIMITED SOFTWARE BASE AND THE ABSENCE OF IBM COMPATIBILITY. AS PREVIOUSLY NOTED, NUMEROUS SOFTWARE PIECES ARE ~~CURRENTLY UNDER~~ /N PRODUCTION AND 52 TITLES ARE CURRENTLY AVAILABLE WITH 65 MORE SCHEDULED BY THE END OF APRIL. A HARDWARE SOLUTION OFFERING IBM COMPATIBILITY IS CURRENTLY UNDER ADVANCED DEVELOPMENT, AND IMPORTANT VERTICAL MARKET PERIPHERALS SUCH AS THE DIGITIZER AND GENLOCK WILL BE ON THE MARKET BY MARCH 1986.

THE SPECIAL CAPABILITIES OF THE AMIGA MAKE IT UNIQUELY SUITED TO CERTAIN VERTICAL MARKETS INCLUDING DESKTOP PUBLISHING, VIDEO SPECIAL EFFECTS, INTERACTIVE EDUCATION AND TRAINING, AND THE MUSIC MARKET. POTENTIAL END-USERS IN THESE MARKETS INCLUDE PUBLISHING COMPANIES, ARCHITECTURE/DESIGN FIRMS, ADVERTISING AGENCIES, ANIMATION HOUSES, CORPORATE MARKETING AND GRAPHIC DEPARTMENTS, AND MUSICIANS AND ARTISTS. POTENTIAL SALES TO THESE MARKETS ALONE COULD REACH 100,000 UNITS PER YEAR.

ALL OF THESE FACTORS SHOULD ENABLE COMMODORE TO MEET OR EXCEED THE UNIT AND REVENUE FORECASTS OUTLINED IN THIS PRESENTATION.

I WOULD NOW LIKE TO TURN THE PRESENTATION OVER TO JOHN KELLY, OUR VICE PRESIDENT OF FINANCE, TO DISCUSS THE FINANCIAL OVERVIEW.

Average Variable Cost Per Unit

		<u>1984</u>	<u>1985</u>	<u>1986</u>
C64	Price	\$185	\$ 135	\$ 135
	Variable Cost	104	83	64
C128/ 128D	Price	-	\$ 243	\$ 213/ 420
	Variable Cost	-	155	129/ 283
PC10	Price	-	\$1050	\$1020
	Variable Cost	-	593	520
AMIGA	Price	-	\$ 842	\$ 725/ 1400
(CPU/ System)	Variable Cost	-	500	442/ 690

Average Variable Cost Per Unit

		<u>1984</u>	<u>1985</u>	<u>1986</u>
C64	United States	\$148	\$ 107	\$ 92
	UK/ Germany	\$150	\$ 111	\$ 95
C128/ 128D	United States	-	\$ 182	\$ 162
	UK/ Germany	-	\$ 182	\$ 182/ 335
PC10	UK/ Germany	-	\$ 740	\$ 715
AMIGA	United States	-	\$ 591	\$ 545
(CPU/ System)	UK/ Germany	-	-	- / 980

Average Price Per Unit

		<u>1984</u>	<u>1985</u>	<u>1986</u>
C64	United States	\$ 192	\$ 133	\$ 132
	UK/ Germany	182	151	136
C128/ 128D	United States	-	\$ 234	\$ 207
	UK/ Germany	-	256	225/ 420
PC10	UK/ Germany	-	\$ 1050	\$ 1020
AMIGA	United States	-	\$ 842	\$ 725
(CPU/ System)	UK/ Germany	-	-	- / 1400

VARIABLE COST PER UNIT

- SLIDE LEFT -

- SLIDE RIGHT -

PRODUCT COSTS FOR THE COMMODORE 64 CONSIST OF APPROXIMATELY 75% FOR PURCHASED COMPONENTS, 15% FOR PROPRIETARY SEMICONDUCTOR DEVICES MANUFACTURED IN-HOUSE, 5% LABOR AND OVERHEAD AND 5% FREIGHT AND DUTY. SEMICONDUCTOR YIELDS HAVE IMPROVED DRAMATICALLY OVER THE PAST TWO YEARS AS A RESULT OF MANUFACTURING EFFICIENCIES FROM VOLUME PRODUCTION AND EXPERIENCE WITH THE LEARNING CURVE. THE COST OF PURCHASED COMPONENTS, ESPECIALLY FOR DYNAMIC RAMS, WAS VERY HIGH IN 1984 DUE TO A WORLDWIDE SUPPLY SHORTAGE. THESE COSTS DECLINED PRECIPITOUSLY IN LATE 1985 AND ARE EXPECTED TO REMAIN RELATIVELY STABLE IN 1986.

A MAJOR PORTION OF COMMODORE'S RESEARCH AND DEVELOPMENT ACTIVITY IS DEVOTED TO COST REDUCTION ENGINEERING. IN MID-1985 SIGNIFICANT COST SAVINGS WERE ACHIEVED ON THE C64 PRINTED CIRCUIT BOARD. PRIMARILY REFLECTING THE COST SAVINGS FROM PURCHASED COMPONENTS, UNIT VARIABLE COST FOR THE C64 DECLINED FROM \$104 IN 1985 TO A FORECAST \$64 IN 1986.

BASED ON ENGINEERING RELATED COST REDUCTIONS, IT IS ALSO ANTICIPATED THAT THE COST OF THE C128 WILL BE REDUCED FROM \$155 LAST YEAR TO \$129 BY MID-1986.

ENGINEERING IMPROVEMENTS ARE ALSO IN PROCESS FOR THE PC10 AND 20 WHICH ARE MANUFACTURED IN BRAUNSCHWEIG, WEST GERMANY. WHEN THE PRODUCT WAS FIRST INTRODUCED IN MID-1985, THE THREE

MAJOR PRINTED CIRCUIT BOARDS WERE ASSEMBLED IN GERMANY. IN LATE 1985, THE ASSEMBLY OF THESE BOARDS WAS SHIFTED TO HONG KONG WHERE COST SAVINGS ARE ALREADY BEING OBTAINED.

THE AMIGA IS MANUFACTURED BY A SUBCONTRACTOR IN JAPAN. WITH THE EXCEPTION OF THE PROPRIETARY SEMICONDUCTOR DEVICES WHICH ARE MANUFACTURED IN VALLEY FORGE, PENNSYLVANIA, ALL OTHER COMPONENTS ARE SOURCED IN JAPAN. AS PRODUCTION VOLUMES HAVE INCREASED, COST BENEFITS HAVE BEEN REALIZED AND BETTER PRICING HAS BEEN OBTAINED FROM OUTSIDE SUPPLIERS WITH VOLUME PURCHASES. THESE COST SAVINGS HAVE MORE THAN OFFSET THE IMPACT OF A 20% YEN APPRECIATION DURING THE LATTER HALF OF 1985. IT IS ANTICIPATED THAT ANY FURTHER STRENGTHENING OF THE YEN IN 1986 CAN BE OFFSET BY COST REDUCTIONS CONTEMPLATED IN THE FUTURE.

THE VARIABLE COST PER UNIT FOR EACH MARKETING SUBSIDIARY IS HIGHER THAN CORPORATE COST BECAUSE IT IS BASED ON TRANSFER PRICES. TRANSFER PRICES ARE ESTABLISHED FOR EACH PRODUCT IN ORDER TO ENABLE THE MARKETING COMPANIES TO EARN A REASONABLE PROFIT. THE TRANSFER PRICING POLICY ALSO TAKES INTO CONSIDERATION THE OVERALL PROCUREMENT AND RESEARCH AND DEVELOPMENT COSTS INCURRED BY THE TRADING COMPANY.

Average Variable Margin Per Unit

		<u>1984</u>	<u>1985</u>	<u>1986</u>
C64	United States UK/ Germany	23% 18%	19% 26%	30% 30%
C128/ 128D	United States UK/ Germany	- -	22% 29%	22% 24%/ 20%
PC10	UK/ Germany	-	30%	30%
AMIGA (CPU/ System)	United States UK/ Germany	- -	30% -	25% - / 30%

Average Variable Profit Per Unit

		<u>1984</u>	<u>1985</u>	<u>1986</u>
C64	Variable Profit Margin	\$ 81 44%	\$ 52 39%	\$ 71 53%
C128/ 128D	Variable Profit Margin	- -	\$ 88 36%	\$ 84/ 137 39/ 33%
PC10	Variable Profit Margin	- -	\$ 457 44%	\$ 500 49%
AMIGA (CPU/ System)	Variable Profit Margin	- -	\$ 342 41%	\$ 283/ 710 39/ 51%

VARIABLE PROFIT PER UNIT

- SLIDE LEFT -

- SLIDE RIGHT -

ALTHOUGH THE VARIABLE PROFIT PER UNIT FOR THE C64 DECLINED TO \$52 PER UNIT IN 1985, IT IS EXPECTED THAT THE PROFIT WILL IMPROVE TO \$71 PER UNIT IN 1986. WHILE COST REDUCTIONS WERE LESS THAN THE PRICE DECLINE IN 1985, STABLE PRICING IN 1986 TOGETHER WITH THE COST SAVINGS OF \$19 PER UNIT ARE EXPECTED TO HAVE A FAVORABLE IMPACT ON VARIABLE PROFIT.

THE C128 AND 128D ARE BOTH NEW PRODUCTS WHICH HAVE NOT YET REALIZED THE FULL BENEFIT OF COST REDUCTION ENGINEERING CHANGES. DUE TO COMPETITIVE PRESSURES, THESE COSTS CANNOT BE FULLY RECOVERED BY PRICING ACTIONS, SO THE VARIABLE PROFIT PER UNIT IN 1986 IS EXPECTED TO DECLINE TO \$84 FROM \$88 IN 1985.

BOTH THE PC AND AMIGA ARE HIGHER PRICED MACHINES WITH CORRESPONDINGLY HIGHER VARIABLE PROFIT OF \$300 TO \$500 PER UNIT.

THE VARIABLE PROFIT EARNED BY EACH MARKETING SUBSIDIARY IS LESS THAN THE OVERALL CORPORATE MARGIN BECAUSE THE SUBSIDIARY PROFIT IS BASED ON TRANSFER PRICES. GENERALLY, TRANSFER PRICING POLICY IS APPLIED TO ENABLE THE MARKETING COMPANY TO EARN 2/3 OF THE TOTAL CORPORATE MARGIN. IN 1985 AND 1986, TRANSFER PRICES WERE REDUCED TO REFLECT INCREASED COMPETITIVE AND PRICING PRESSURES FACED BY THE MARKETING COMPANIES.

Income Statement

\$ In Millions

1984

1985

1986

Revenues

\$1,209

\$799

\$855

Revenues

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$ 512	\$344	\$405
United Kingdom	110	49	45
Germany	187	125	135
Other	<u>400</u>	<u>281</u>	<u>270</u>
Total Revenues	\$1,209	\$799	\$855

REVENUES

- SLIDE LEFT -

- SLIDE RIGHT -

REVENUES REACHED A PEAK OF \$1.2 BILLION IN 1984 WITH THE SUCCESS OF THE COMMODORE 64. SALES DECLINED 33% IN 1985 BUT ARE EXPECTED TO INCREASE 7% TO \$855 MILLION IN 1986.

AS A RESULT OF CERTAIN PRODUCTION DELAYS, THE C128 WAS NOT INTRODUCED IN THE U.S. UNTIL LATE 1985, WHEREAS C64 SALES BEGAN DECLINING IN EARLY 1985. THE INCREMENTAL REVENUE FROM THE C128 AND AMIGA WAS NOT SUFFICIENT TO OFFSET THIS DECLINE AND TOTAL U.S. REVENUES DECREASED 33% IN 1985 TO \$344 MILLION. THE DECREASE IN VOLUME WAS ESPECIALLY SEVERE IN THE JUNE QUARTER WHEN TOTAL U.S. REVENUES WERE \$46 MILLION. THE INTRODUCTION OF THE C128 PRIOR TO THE CHRISTMAS SELLING SEASON ENABLED U.S. REVENUES TO REBOUND TO \$73 MILLION IN THE SEPTEMBER QUARTER AND \$140 MILLION IN THE DECEMBER QUARTER. WITH THE GROWTH OF DEMAND FOR THE AMIGA AND INTRODUCTION OF A PC IN MID-1986, U.S. SALES ARE EXPECTED TO INCREASE 18% TO \$405 MILLION.

AS MANY OF YOU ARE AWARE, A SEVERE PRICE WAR ERUPTED IN THE U.K. IN 1985. COMMODORE CHOSE NOT TO ENTER THE BATTLE IN ORDER TO PROTECT ITS LARGER MARKET SHARES IN THE OTHER EUROPEAN COUNTRIES. U.K. REVENUES DECLINED BY MORE THAN 55% IN 1985 AND A SMALL DECLINE IS ALSO ANTICIPATED FOR 1986.

ON THE OTHER HAND, THE GERMAN MARKET HAS BEEN ONE OF THE COMPANY'S STRONGEST AREAS. ALTHOUGH UNIT VOLUMES OF THE C64 DECLINED BY 50% IN 1985, TOTAL REVENUES DECREASED ONLY 33% DUE TO INCREMENTAL REVENUES FROM THE C128 AND THE PC 10/20. WITH COMMODORE'S GROWING PRESENCE IN THE BUSINESS MARKET IN GERMANY, REVENUES FOR 1986 ARE EXPECTED TO INCREASE TO \$135 MILLION. IT

IS EXPECTED THAT THE PC 10/20 WILL REPRESENT 25% AND THE AMIGA 15% OF THE TOTAL. THE C64 AND C128 PRODUCTS ARE PROJECTED TO ACCOUNT FOR THE REMAINING 60% OF REVENUES.

NEW MARKETS ARE BEING DEVELOPED IN FRANCE, LATIN AMERICA AND EASTERN EUROPE. AS SALES OF THE C64 MATURE IN THE EXISTING MARKETS, DEMAND IS GENERATED FROM THE NEW COUNTRIES. ALTHOUGH REVENUES IN THE MARKETS EXCLUDING THE U.S., U.K., AND GERMANY DECLINED TO \$281 MILLION IN 1985 THEY ARE EXPECTED TO REMAIN LEVEL IN 1986.

OVERALL, COMMODORE BELIEVES THAT THE NEW PRODUCTS WHICH HAVE BEEN DEVELOPED WITH GREAT EFFORT AND RESOURCES DURING THE PAST YEAR WILL BEAR FRUITION IN 1986 AND ENABLE THE COMPANY TO RESUME THE UPWARD GROWTH PATTERN OF REVENUES.

Variable Profit - Standard

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
C64 Group	\$527	\$125	\$ 69
C128 Group	-	55	84
PC Group	-	27	51
Amiga Group	-	17	134
Other	<u>20</u>	<u>(8)</u>	<u>(11)</u>
Total Variable Profit - Standard	\$547	\$216	\$327

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Costs - Standard	<u>662</u>	<u>583</u>	<u>528</u>
Variable Profit - Standard	547	216	327
Margin	45%	27%	38%

VARIABLE COSTS AND PROFIT-STANDARD

- SLIDE LEFT -

- SLIDE RIGHT -

ALTHOUGH COMMODORE'S UNIT PRODUCT COSTS HAVE DECLINED AS EACH PRODUCT ACHIEVED A HIGH VOLUME OF PRODUCTION, VARIABLE PROFIT HAS BEEN ADVERSELY AFFECTED BY A MORE RAPID DECLINE OF REVENUES. IN 1984, THE C64 GROUP ACCOUNTED FOR ALMOST ALL OF THE STANDARD VARIABLE PROFIT OF \$547 MILLION, REPRESENTING A MARGIN OF 45%. THIS MARGIN IS BASED ON STANDARD COSTS WHICH ARE REVISED TO REFLECT CURRENT MARKET COSTS FOR PURCHASED COMPONENTS AND CAPACITY UTILIZATION FOR MANUFACTURING FACILITIES.

DUE TO OVERLY OPTIMISTIC SALES AND PRODUCTION PLANS FOR THE DECEMBER 1984 QUARTER, COMMODORE ENTERED 1985 WITH \$449 MILLION OF INVENTORY. A PLAN WAS UNDERTAKEN TO SELL A LARGE PORTION OF THE INVENTORY, ESPECIALLY PERIPHERALS, AT SHARPLY REDUCED PRICES AT THE SACRIFICE OF GROSS MARGIN. IN ORDER NOT TO DISRUPT THE EXISTING MARKETPLACE, THESE PRICING ACTIONS GENERALLY TOOK THE FORM OF BUNDLING. IN ADDITION, SOME DISCONTINUED PRODUCTS WERE SOLD TO LIQUIDATORS IN THE U.S. ALTHOUGH THE VARIABLE MARGIN ON THE C64 WAS 39% IN 1985, THE SALE OF A LARGE AMOUNT OF PERIPHERALS AT LITTLE OR NO MARGIN RESULTED IN AN OVERALL MARGIN OF 27% FOR 1985. THE NEW PRODUCTS INTRODUCED IN 1985, NAMELY THE C128, PC10/20 AND AMIGA CONTRIBUTED \$99 MILLION, OR 46% OF TOTAL VARIABLE PROFIT.

WITH THE EXPECTED RETURN TO MORE STABLE PRICING IN 1986 AND THE RAPID GROWTH OF THE HIGHER MARGIN PC AND AMIGA PRODUCTS, THE OVERALL VARIABLE MARGIN IS EXPECTED TO INCREASE TO 38% FOR A TOTAL VARIABLE PROFIT OF \$327 MILLION. THE AMIGA IS EXPECTED TO ACCOUNT FOR ABOUT 40% OF THIS AMOUNT.

Unallocated Variable Costs

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Inventory Writedowns	\$ 31	\$ 91	-
Air Freight	20	16	10
Product Allowances	24	-	-
Unabsorbed Labor and Overhead	14	35	17
Other	26	41	21
	<u> </u>	<u> </u>	<u> </u>
Total Unallocated Variable Costs	\$115	\$183	\$48

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Costs - Standard	<u>662</u>	<u>583</u>	<u>528</u>
Variable Profit - Standard	547	216	327
Margin	45%	27%	38%
Unallocated Variable Costs	115	183	48

UNALLOCATED VARIABLE COSTS

- SLIDE LEFT -

- SLIDE RIGHT -

UNALLOCATED VARIABLE COSTS INCLUDE INVENTORY WRITEDOWNS, AIR FREIGHT, AND COST INEFFICIENCIES OF PURCHASING AND MANUFACTURING. INVENTORY WRITEDOWNS HAVE BEEN THE LARGEST COST IN THIS CATEGORY.

IN EARLY 1984, THE VIC PRODUCT LINE WAS DISCONTINUED AND WRITEOFFS WERE TAKEN FOR EXCESS PRODUCTION PARTS. ADDITIONAL WRITEDOWNS WERE ALSO TAKEN FOR THE PORTABLE SX64, EXCESS C64 SOFTWARE TITLES AND ESTIMATED LOSSES ON DISPOSAL OF CERTAIN PRINTERS. TOTAL INVENTORY WRITEDOWNS IN 1984 WERE \$31 MILLION.

IN LATE 1984 THE TED PRODUCT SERIES, THE C16 AND PLUS 4, WERE LAUNCHED BUT DID NOT GAIN ACCEPTANCE IN THE MARKET. WRITEDOWNS OF \$15 MILLION FOR EXCESS TED PRODUCTION PARTS AND \$30 MILLION FOR ANTICIPATED LOSSES FROM DISPOSAL OF FINISHED GOODS WAS MADE.

AFTER THE INTRODUCTION OF THE PC10/20 IN EUROPE, DEMAND FOR THE PET BUSINESS SYSTEMS DECREASED SIGNIFICANTLY THROUGH THE END OF 1985. A WRITEDOWN OF \$11 MILLION WAS TAKEN FOR EXCESS PET PRODUCTION PARTS AND FOR POTENTIAL LOSSES ON DISPOSAL OF PET FINISHED GOODS. DURING 1985 THERE WERE FURTHER WRITEDOWNS OF \$35 MILLION FOR SLOW-MOVING PERIPHERALS AND SOFTWARE, LOSSES ON REFURBISHED UNITS AND EXCESS PRODUCTION PARTS. TOTAL INVENTORY WRITEDOWNS AMOUNTED TO \$91 MILLION IN 1985.

DUE TO EXTENSIVE WRITEDOWNS OVER THE PAST TWO YEARS AND A RECENT, COMPREHENSIVE INVENTORY REVIEW, INVENTORY RESERVES ARE BELIEVED TO BE ADEQUATE AND NO FURTHER WRITEDOWNS ARE ANTICIPATED FOR 1986.

AS A RESULT OF PRODUCTION DELAYS AND SCHEDULING PROBLEMS IN THE FAR EAST, COMMODORE HAS HAD TO RELY HEAVILY ON AIR FREIGHT OVER THE PAST TWO YEARS. IN 1984 AIR FREIGHT WAS \$20 MILLION AND WAS INCURRED IN ALL FOUR QUARTERS. IN 1985 AIR FREIGHT WAS \$16 MILLION AND WAS INCURRED IN THE LAST HALF OF THE YEAR TO RUSH THE C128, 1571 DRIVE AND AMIGA TO THE MARKETPLACE FOR THE CRUCIAL CHRISTMAS SELLING SEASON. FOR PRINTED CIRCUIT BOARDS, IT IS COST EFFECTIVE TO UTILIZE AIR FREIGHT TO MINIMIZE THE INTRANSIT TIME FROM THE FAR EAST. ALL ATTEMPTS WILL BE MADE TO MINIMIZE AIR FREIGHT FOR OTHER PARTS IN 1986, BUT IT IS ANTICIPATED THAT A CERTAIN AMOUNT OF AIR FREIGHT WILL BE NEEDED TO MEET DELIVERY COMMITMENTS.

IN 1984 A PROVISION OF \$24 MILLION WAS MADE FOR ADDITIONAL PRODUCT ALLOWANCES TO BE GIVEN TO U.S. DEALERS AND DISTRIBUTORS FOR COMMODORE INVENTORY ON HAND AT THE TIME THE C64 PRICE WAS LOWERED. NO SPECIAL ALLOWANCES WERE REQUIRED IN 1985 AND NONE ARE ANTICIPATED THIS YEAR.

DUE TO LOWER CPU VOLUME IN 1985 COMMODORE HAD BOTH EXCESS MANUFACTURING CAPACITY AND PRODUCTION SCHEDULING PROBLEMS AT PEAK PERIODS. DUE TO THESE INEFFICIENCIES THE LABOR AND OVERHEAD INCURRED WAS IN EXCESS OF THE STANDARD COST BY \$35 MILLION. APPROXIMATELY HALF OF THAT AMOUNT RELATED TO THE SEMICONDUCTOR OPERATIONS. ALTHOUGH TOTAL SEMICONDUCTOR EMPLOYMENT WAS REDUCED FROM 1,000 PEOPLE AT DECEMBER 31, 1984 TO 430 PEOPLE AT DECEMBER 31, 1985, TOTAL COSTS COULD NOT BE REDUCED PROPORTIONATELY DUE TO THE LARGE AMOUNT OF DEPRECIATION. IN JANUARY 1986 ADDITIONAL MANPOWER REDUCTIONS WERE MADE WITH THE PERMANENT CLOSING OF THE MANUFACTURING PLANT IN COSTA MESA, CALIFORNIA. DUE TO THE HEAVY

INVESTMENT IN EQUIPMENT AND THE CONTINUOUS NATURE OF THE SEMICONDUCTOR MANUFACTURING PROCESS, MANY OF THE COSTS OF VALLEY FORGE CANNOT BE REDUCED SIGNIFICANTLY WHEN VOLUME CONTRACTS. THE PLANT IS EXPECTED TO OPERATE AT ONLY 50% OF CAPACITY IN EARLY 1986 BUT MANAGEMENT IS ATTEMPTING TO OBTAIN OUTSIDE SALES WHICH WILL INCREASE CAPACITY UTILIZATION THEREBY REDUCING UNABSORBED LABOR AND OVERHEAD TO ZERO BY YEAR-END 1986. CERTAIN PRODUCTION AND WAREHOUSE COSTS IN JAPAN ARE NOT ALLOCATED BY PRODUCT AND THESE COSTS WILL CONTINUE IN 1986 BUT AT A REDUCED LEVEL.

OTHER VARIANCES CONSIST OF MATERIAL PRICE, MATERIAL USAGE, REWORK AND REPAIR COSTS, TOOLING, ROYALTIES, AND SEMICONDUCTOR YIELD VARIANCE. THESE COSTS WERE HIGH IN 1985 DUE TO A LARGE AMOUNT OF QUALITY RELATED REWORK AND SEVERAL SPECIAL ADJUSTMENTS, INCLUDING \$4 MILLION FOR CUSTOMS PROBLEMS. WITH THE QUALITY IMPROVEMENTS WHICH HAVE BEEN MADE, IT IS ANTICIPATED THAT THESE OTHER VARIANCES WILL DECREASE IN 1986.

Variable Profit

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$122	\$40	\$109
United Kingdom	27	2	7
Germany	35	20	29
Other	<u>248</u>	<u>29</u>	<u>134</u>
Total Variable Profit	\$432	\$33	\$279

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Costs - Standard	<u>662</u>	<u>583</u>	<u>528</u>
Variable Profit - Standard	547	216	327
Margin	45%	27%	38%
Unallocated Variable Costs	<u>115</u>	<u>183</u>	<u>48</u>
Variable Profit	432	33	279

VARIABLE PROFIT

- SLIDE LEFT -

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AS A RESULT OF THE SIGNIFICANT INVENTORY WRITEDOWNS AND THE DECLINE IN STANDARD MARGIN DISCUSSED EARLIER, TOTAL VARIABLE PROFIT IN 1985 DECLINED DRAMATICALLY TO \$33 MILLION. WITH A FORECAST RETURN TO A MUCH IMPROVED STANDARD MARGIN IN 1986 AND A REDUCTION OF UNALLOCATED VARIABLE COSTS, VARIABLE PROFIT IN 1986 IS EXPECTED TO REACH \$279 MILLION, OR 33% OF SALES.

EACH OPERATING COMPANY PURCHASES APPROXIMATELY 95% OF ITS PRODUCTS FROM COMMODORE ELECTRONICS LIMITED ("CEL"), THE HOLDING COMPANY RESPONSIBLE FOR TRADING, MANUFACTURING AND RESEARCH AND DEVELOPMENT. A TRANSFER PRICE IS ESTABLISHED FOR EACH PRODUCT IN LOCAL CURRENCY SO THAT THE MARKETING COMPANY EARNS A REASONABLE GROSS MARGIN AFTER TAKING INTO ACCOUNT VARIOUS FACTORS, INCLUDING THE LOCAL CURRENCY SELLING PRICE. FOR CERTAIN SPECIFIED PRODUCTS, CEL REIMBURSES THE MARKETING COMPANIES FOR ANY LOSSES INCURRED BY SELLING PRODUCTS BELOW THE TRANSFER PRICE. CEL ABSORBS MOST OF THE UNALLOCATED VARIABLE COSTS. AS A RESULT OF SIGNIFICANT INVENTORY WRITEDOWNS, CEL HAD A VARIABLE LOSS IN 1985, BUT MARGINS ARE EXPECTED TO IMPROVE FOR ALL SUBSIDIARIES IN 1986.

Advertising And Merchandising

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$ 45	\$48	\$44
United Kingdom	10	6	3
Germany	11	9	7
Other	<u>44</u>	<u>23</u>	<u>21</u>
Total Advertising and Merchandising	\$110	\$86	\$75

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses			
Advertising and Merchandising	110	86	75

EXPENSES

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BEING A CONSUMER ELECTRONICS COMPANY, ADVERTISING AND MERCHANDISING IS COMMODORE'S LARGEST EXPENSE. IN 1984, THIS EXPENSE WAS A RECORD \$110 MILLION, OR 9.1% OF SALES. AS REVENUES DECREASED IN 1985, ADVERTISING AND MERCHANDISING ALSO DECREASED BUT AS A PERCENTAGE OF SALES IT INCREASED TO 10.8%. FOR 1986 MANAGEMENT HAS ADOPTED A RIGID POLICY THAT ADVERTISING AND MERCHANDISING MUST BE HELD TO 10-10.5% IN THE U.S. AND 5-6% IN ALL OTHER COUNTRIES. THE U.S. PERCENTAGE IS HIGHER THAN THE REST OF THE WORLD DUE TO COOPERATIVE ADVERTISING WITH DEALERS AND DISTRIBUTORS.

AS A RESULT OF THIS NEW POLICY, ADVERTISING AND MERCHANDISING IN 1986 IS FORECAST TO BE \$75 MILLION OR 8.8% OF SALES. TOTAL ADVERTISING AND MERCHANDISING IN THE U.S. IS EXPECTED TO DECREASE IN 1986 BY 10% TO \$44 MILLION EVEN THOUGH REVENUES ARE PROJECTED TO INCREASE.

Selling And Delivery

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$25	\$27	\$34
United Kingdom	5	5	3
Germany	6	5	7
Other	<u>20</u>	<u>33</u>	<u>21</u>
Total Selling and Delivery	\$56	\$70	\$65

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses			
Advertising and Merchandising	110	86	75
Selling and Delivery	56	70	65

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SELLING AND DELIVERY EXPENSES INCLUDE SALES RELATED PERSONNEL COSTS, COMMISSIONS FOR OUTSIDE SALES REPRESENTATIVES, BAD DEBTS, AND WAREHOUSE EXPENSES. SELLING AND DELIVERY EXPENSES INCREASED IN 1985 TO \$70 MILLION DUE TO SEVERAL NON-RECURRING CHARGES. THERE WAS A PROVISION OF \$3 MILLION FOR BAD DEBTS IN ITALY AND A WRITEOFF OF \$5 MILLION FOR UNUTILIZED BARTER CREDITS WHICH HAD BEEN OBTAINED FROM THE SALE OF DISCONTINUED PRODUCTS.

DESPITE THE DECLINE IN REVENUES IN 1985, U.S. SELLING AND DELIVERY EXPENSES INCREASED SLIGHTLY TO \$27 MILLION AS A RESULT OF NO MANPOWER REDUCTIONS. IN LATE 1985, THE AMIGA STARTED BEING SOLD BY OUTSIDE SALE REPRESENTATIVES WHO EARN A 5% COMMISSION. IN ADDITION, THE COMPANY IS PAYING THE COSTS OF A FLOOR PLAN FINANCING ARRANGEMENT FOR THE AMIGA DEALERS. IN 1986, FLOOR PLAN FINANCING COSTS ARE EXPECTED TO BE \$6 MILLION. THE ADDED SELLING EXPENSES FOR THE AMIGA ACCOUNT FOR THE SIGNIFICANT INCREASE IN U.S. SELLING AND DELIVERY EXPENSES TO \$34 MILLION IN 1986. EFFORTS ARE BEING MADE TO REDUCE U.S. SELLING AND DELIVERY EXPENSES SO THAT THEY WILL BE MORE IN LINE WITH GERMANY, WHICH IS EXPECTED TO BE 5% OF REVENUES.

General And Administration

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$11	\$13	\$10
United Kingdom	2	1	1
Germany	2	3	3
Other	19	20	20
	<u> </u>	<u> </u>	<u> </u>
Total General and Administration	\$34	\$37	\$34

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses			
Advertising and Merchandising	110	86	75
Selling and Delivery	56	70	65
General and Administration	34	37	34

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WORLDWIDE GENERAL AND ADMINISTRATION EXPENSES INCREASED BY LESS THAN 10% IN 1985 TO \$37 MILLION. THESE EXPENSES WOULD HAVE BEEN LEVEL WITH 1984, BUT DUE TO THE WEAKENED FINANCIAL CONDITION OF THE COMPANY, THERE WAS A SIGNIFICANT AMOUNT SPENT FOR OUTSIDE PROFESSIONAL SERVICES. IN 1986 THE BASE LEVEL OF ADMINISTRATION EXPENSES IS EXPECTED TO DECREASE BUT THE EXPENSES WILL REMAIN AT \$34 MILLION DUE TO THE HIGH AMOUNT OF PROFESSIONAL FEES. IN ADDITION, THE COST OF OFFICERS' AND DIRECTORS' LIABILITY INSURANCE HAS INCREASED DRAMATICALLY.

Research And Development

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
U.S. Engineering	\$15	\$19	\$11
Amiga Engineering	1	9	7
Semiconductor, Including Defective Devices	12	10	2
Japan, Braunschweig, Software and Prototype Machines	11	12	7
Amortization of Acquired Technology	<u>-</u>	<u>4</u>	<u>8</u>
Total Research and Development	\$39	\$54	\$35

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses			
Advertising and Merchandising	110	86	75
Selling and Delivery	56	70	65
General and Administration	34	37	34
Research and Development	39	54	35

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RESEARCH AND DEVELOPMENT EXPENSES REACHED A PEAK OF \$54 MILLION IN 1985 AS COMMODORE COMPLETED MAJOR DEVELOPMENT WORK ON THE C128, PC10/20 AND AMIGA. THE ENGINEERING EFFORT INCLUDES HARDWARE AND SOFTWARE DEVELOPMENT, MANUFACTURING PROCESS DEVELOPMENT, ADVANCED TECHNOLOGY AND DOCUMENTATION AND CONTROL.

DURING THE DEVELOPMENT PROCESS OF THE PROPRIETARY SEMICONDUCTORS FOR THE C128 AND AMIGA, THERE WAS A SIGNIFICANT AMOUNT OF DEFECTIVE MATERIAL. THE KEY ADVANTAGE OF HAVING IN-HOUSE SEMICONDUCTOR MANUFACTURING CAPABILITY IS THAT THE DESIGN AND DEVELOPMENT TIME FRAME CAN BE SIGNIFICANTLY COMPRESSED BECAUSE CHANGES CAN BE MADE WHILE INITIAL TEST RUNS ARE BEING COMPLETED.

IN 1985, THE COMPANY BEGAN AMORTIZATION OF THE ACQUISITION COSTS OF AMIGA. THIS AMORTIZATION WAS \$4 MILLION FOR THE LAST HALF OF 1985 AND IS PROJECTED TO BE \$8 MILLION FOR 1986.

IN 1986, THE RESEARCH AND DEVELOPMENT ACTIVITY WILL BECOME MORE NARROWLY FOCUSED TO EMPHASIZE PRODUCT ENHANCEMENT AND ENGINEERING COST REDUCTION FOR THE CORE PRODUCT LINES.

WORLDWIDE ENGINEERING MANPOWER REACHED A PEAK OF 360 IN JUNE 1985 BUT WAS REDUCED TO 280 BY DECEMBER. A FURTHER REDUCTION OF 60 PEOPLE IS FORECAST BY MID-1986 WITH ANNUALIZED SAVINGS OF \$3 MILLION.

Interest Expense

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$19	\$22	\$15
United Kingdom	2	3	2
Germany	2	6	6
Other	<u>1</u>	<u>4</u>	<u>3</u>
Total Interest Expense	\$24	\$35	\$26

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses			
Advertising and Merchandising	110	86	75
Selling and Delivery	56	70	65
General and Administration	34	37	34
Research and Development	39	54	35
Interest Expense	24	35	26

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INTEREST EXPENSE INCREASED FROM \$24 MILLION IN 1984 TO \$35 MILLION IN 1985 AS A RESULT OF AN INCREASE IN AVERAGE BORROWINGS OUTSTANDING. DUE TO A \$50 MILLION REDUCTION IN BANK DEBT IN NOVEMBER AND DECEMBER 1985, INTEREST EXPENSE FOR 1986 IS FORECAST TO DECREASE TO \$26 MILLION.

INTEREST EXPENSE FOR EACH COUNTRY INCLUDES INTEREST ON LONG-TERM INTERCOMPANY BALANCES. IN 1985, GERMANY OBTAINED ADDITIONAL INTERCOMPANY FINANCING FROM THE 100 MILLION DEUTSCHE MARK DEBENTURE OFFERING WITH A CORRESPONDING INCREASE IN INTEREST EXPENSE. WITH THE PRO-RATA REDUCTION OF BANK DEBT, INTEREST EXPENSE FOR ALL SUBSIDIARIES IS EXPECTED TO DECLINE IN 1986.

Other Expenses (Income)

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Sale/ Writeoff Equipment	-	\$25	-
Realized Currency	\$19	(14)	-
Other	<u>(3)</u>	<u>(1)</u>	<u>-</u>
Total Other Expenses (Income)	\$16	\$ 9	-

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses			
Advertising and Merchandising	110	86	75
Selling and Delivery	56	70	65
General and Administration	34	37	34
Research and Development	39	54	35
Interest Expense	24	35	26
Other Expense (Income)	16	9	--

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IN JANUARY 1986, A DECISION WAS MADE TO CLOSE THE SEMICONDUCTOR MANUFACTURING FACILITY IN COSTA MESA, CALIFORNIA AND THE COMPUTER ASSEMBLY PLANT IN THE UNITED KINGDOM. THE SHUTDOWN COSTS WERE ESTIMATED TO BE \$19 MILLION FOR COSTA MESA AND \$3 MILLION FOR THE U.K. IN ADDITION, THE CANADIAN OFFICE EQUIPMENT DIVISION WAS SOLD IN JUNE 1985 AT A LOSS OF U.S. \$1 MILLION AND ADDITIONAL WRITEDOWNS OF \$3 MILLION WERE TAKEN IN JUNE FOR IDLE SEMICONDUCTOR EQUIPMENT. THE CORPORATE JET WAS SOLD FOR A GAIN OF \$1 MILLION. TOTAL LOSS FROM THESE ASSET SALES AND WRITEDOWNS WAS \$25 MILLION.

AS DISCUSSED EARLIER, EACH MARKETING COMPANY PURCHASES PRODUCTS FROM COMMODORE ELECTRONICS LIMITED IN LOCAL CURRENCY. AS PAYMENTS ARE MADE BY THE MARKETING COMPANIES, CURRENCY GAINS AND LOSSES ARE RECOGNIZED AND RECORDED AS OTHER INCOME AND EXPENSE. IN 1984, CURRENCY LOSSES WERE \$19 MILLION BUT IN 1985 THERE WERE GAINS OF \$14 MILLION. NO MATERIAL EXCHANGE IMPACT IS EXPECTED FOR 1986.

Total Fixed Expenses

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$108	\$111	\$103
United Kingdom	20	15	9
Germany	21	20	23
Other	<u>130</u>	<u>140</u>	<u>100</u>
Total Fixed Expenses	\$279	\$291	\$235

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses			
Advertising and Merchandising	110	86	75
Selling and Delivery	56	70	65
General and Administration	34	37	34
Research and Development	39	54	35
Interest Expense	24	35	26
Other Expense (Income)	<u>16</u>	<u>9</u>	<u>--</u>
Total Fixed Expenses	279	291	235

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TOTAL EXPENSES INCREASED 4% IN 1985 AND ARE PROJECTED TO DECREASE 21% TO \$235 MILLION IN 1986. COMMODORE IS CONTINUING TO IDENTIFY OTHER AREAS FOR PROFIT IMPROVEMENT AND AN ACTION PLAN IS BEING DEVELOPED TO REALIZE ADDITIONAL COST SAVINGS AS SOON AS POSSIBLE.

IN 1986, IT IS EXPECTED THAT MAJOR DECREASES IN TOTAL EXPENSES WILL OCCUR IN THE UNITED KINGDOM WHERE ALL EXPENSES WILL BE TIGHTLY CONTROLLED. IN GERMANY, TOTAL EXPENSES IN 1986 ARE NOT EXPECTED TO INCREASE IN LOCAL CURRENCY BUT DUE TO THE WEAKENED US DOLLAR, EXPENSES IN DOLLAR TERMS SHOW AN INCREASE.

Pre-Tax Income

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$ 13	\$ (71)	\$ 6
United Kingdom	6	(13)	(2)
Germany	14	(3)	6
Other	<u>120</u>	<u>(171)</u>	<u>34</u>
Total Pre-Tax Income	\$153	\$(258)	\$44

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses	<u>279</u>	<u>291</u>	<u>235</u>
Pre-Tax Income	153	(258)	44

PRETAX INCOME

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THE SHARP DETERIORATION IN VARIABLE PROFIT WAS THE MAJOR REASON FOR THE 1985 PRE-TAX LOSS OF \$258 MILLION. WITH THE RETURN TO IMPROVED MARGINS IN 1986, PRE-TAX INCOME IS FORECAST TO IMPROVE BY \$302 MILLION TO A PROFIT OF \$44 MILLION.

WITH THE SIGNIFICANT WORLDWIDE LOSSES IN 1985, THE TRANSFER PRICING SYSTEM HAS BEEN REEVALUATED AND EFFORTS HAVE BEEN MADE TO INCREASE THE PROFITABILITY OF THE MARKETING SUBSIDIARIES TO MEET THE COMPETITIVE PRESSURES OF THE MARKETPLACE. WITH THE REDUCTION IN SEMICONDUCTOR LOSSES AND IMPROVED MARGINS, THE U.S. IS EXPECTED TO EARN \$6 MILLION. DUE TO THE TOUGH COMPETITIVE ENVIRONMENT IN THE U.K., PROFITABILITY IS NOT FORECAST TO BE ATTAINABLE, WHILE GERMANY IS EXPECTED TO EARN \$6 MILLION BEFORE INCOME TAXES.

Income Taxes

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$ 7	\$(21)	-
United Kingdom	3	(4)	-
Germany	6	(2)	3
Other	<u>37</u>	<u>6</u>	<u>13</u>
Total Income Taxes	\$53	\$(21)	\$16

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$799	\$855
Variable Profit	432	33	279
Fixed Expenses	<u>279</u>	<u>291</u>	<u>235</u>
Pre-Tax Income	153	(258)	44
Income Taxes	53	(21)	16

INCOME TAXES

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IN 1985, A LARGE PORTION OF THE LOSSES WERE INCURRED IN COUNTRIES WHICH HAVE VERY LOW TAX RATES, AND ACCORDINGLY, NO INCOME TAX BENEFIT WAS RECOGNIZED. TOTAL TAX BENEFIT WAS \$21 MILLION OR 8% OF PRE-TAX INCOME. IN 1986, THE INCOME TAX PROVISION IS EXPECTED TO BE \$16 MILLION, OR 36% OF PRE-TAX INCOME. IN THE U.S., THERE IS EXPECTED TO BE NO TAX PROVISION IN 1986 DUE TO THE UTILIZATION OF 1985 LOSS CARRYFORWARDS. TAXES IN OTHER COUNTRIES INCLUDE A PROVISION FOR POTENTIAL INCOME TAX DEFICIENCIES. BY THE END OF 1986, THIS RESERVE, WHICH HAS BEEN ACCUMULATED SINCE 1983, IS EXPECTED TO AMOUNT TO \$50 MILLION. MANAGEMENT CONTINUALLY MONITORS THE ADEQUACY OF THE RESERVE IN CONJUNCTION WITH ITS OUTSIDE TAX COUNSEL.

Net Income

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
United States	\$ 6	\$ (50)	\$ 6
United Kingdom	3	(9)	(2)
Germany	8	(1)	3
Other	<u>83</u>	<u>(177)</u>	<u>21</u>
Total Net	\$100	\$(237)	\$28

Income Statement

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Revenues	\$1,209	\$ 799	\$855
Variable Profit	432	33	279
Fixed Expenses	<u>279</u>	<u>291</u>	<u>235</u>
Pre-Tax Income	153	(258)	44
Income Taxes	<u>53</u>	<u>(21)</u>	<u>16</u>
Net Income	<u>\$ 100</u>	<u>\$(237)</u>	<u>\$ 28</u>

NET INCOME

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BASED ON ALL OF THE ACTIONS DESCRIBED EARLIER, ESPECIALLY THE IMPROVEMENT IN VARIABLE MARGINS AND THE COST CONTAINMENT PROGRAMS, COMMODORE SHOULD RETURN TO PROFITABILITY IN 1986. NET INCOME IS EXPECTED TO BE \$28 MILLION, OR 3% OF SALES.

Cash Flow

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Total Sources	\$ 154	\$ (82)	\$ 60

Cash Flow - Sources

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Net Income (Loss)	\$ 100	\$ (237)	\$ 28
Inventory Writedowns	31	91	-
Property Writedowns	-	25	-
Depreciation & Amortization	23	39	32
Total Sources	<u>\$ 154</u>	<u>\$ (82)</u>	<u>\$ 60</u>

CASH FLOW

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AFTER NET INCOME OF \$100 MILLION IN 1984, THE COMPANY'S FORTUNES TOOK A SEVERE DOWNTURN AND A NET LOSS OF \$237 MILLION WAS RECORDED IN 1985. REFLECTING THIS DECLINE, TOTAL CASH SOURCES AMOUNTED TO A NEGATIVE \$82 MILLION IN 1985, EVEN AFTER ADJUSTMENTS FOR INVENTORY AND PROPERTY WRITEDOWNS. WITH THE FORECAST RETURN TO PROFITABILITY, TOTAL SOURCES ARE EXPECTED TO INCREASE TO \$60 MILLION IN 1986.

Cash Flow - Uses

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Capital Expenditures	\$ (58)	\$ (42)	\$ (14)
Amiga Acquisition (Cash Portion)	(14)	-	-
Working Capital	(137)	126	(11)
Other, Net	2	(9)	2
Total Uses	<u>\$(207)</u>	<u>\$ 75</u>	<u>\$ (23)</u>

Cash Flow

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Total Sources	\$ 154	\$ (82)	\$ 60
Total Uses	(207)	75	(23)

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TURNING TO CASH USES, MAJOR CAPITAL EXPENDITURES WERE FOR SEMICONDUCTOR AND OTHER MANUFACTURING EQUIPMENT. WITH THE CURRENT RATIONALIZATION OF MANUFACTURING FACILITIES, CAPITAL EXPENDITURES IN 1986 ARE FORECAST TO BE MUCH LOWER AND REPRESENT UPGRADED EQUIPMENT TO IMPROVE PRODUCT QUALITY.

IN 1984, WORKING CAPITAL RESULTED IN A NET USE OF FUNDS OF \$137 MILLION DUE TO THE SIGNIFICANT INVENTORY BUILDUP AT THE END OF THE YEAR, WITH ONLY A NOMINAL INCREASE IN PAYABLES. THE INVENTORY BUILDUP WAS REVERSED BY SALES AND WRITEDOWNS IN 1985 WHICH, COUPLED WITH A REDUCTION IN BOTH RECEIVABLES AND PAYABLES, GREATLY REDUCED THE CASH NEEDED FOR WORKING CAPITAL. IN 1986, WORKING CAPITAL IS EXPECTED TO BE A NOMINAL USE OF FUNDS.

PRIMARILY REFLECTING THE SHIFT IN WORKING CAPITAL, TOTAL USES OF \$207 MILLION IN 1984 ACTUALLY BECAME A SOURCE OF \$75 MILLION IN 1985. TOTAL USES ARE FORECAST TO BE \$23 MILLION THIS YEAR.

Cash Flow

United States

\$ In Millions	<u>1985</u>	<u>1986</u>
<u>Sources</u>		
Net Income	\$ (50)	\$ 6
Depreciation	20	11
Capital Contribution	17	-
Total Sources	<u>(13)</u>	<u>17</u>
<u>Uses</u>		
Capital Expenditures	(26)	(7)
Working Capital	59	12
Other, Net	<u>(1)</u>	<u>1</u>
Total Uses	<u>32</u>	<u>6</u>
Net Cash Flow	<u>\$ 19</u>	<u>\$23</u>

Cash Flow

\$ In Millions	<u>1984</u>	<u>1985</u>	<u>1986</u>
Total Sources	\$ 154	\$ (82)	\$ 60
Total Uses	(207)	75	(23)
	<u> </u>	<u> </u>	<u> </u>
Net Cash Flow	\$ (53)	\$ (7)	\$ 37

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NET CASH FLOW WAS NEGATIVE IN 1984, NEAR BREAKEVEN IN 1985 AND IS FORECAST TO BE \$37 MILLION THIS YEAR. THE DEFICIT IN 1984 WAS FINANCED BY BANK DEBT. IN EARLY 1985, THE EQUIVALENT OF \$33 MILLION WAS OBTAINED FROM A DEBENTURE OFFERING IN GERMANY. THE PROCEEDS WERE USED TO FINANCE WORKING CAPITAL NEEDS. BY THE END OF 1985, HOWEVER, SUFFICIENT CASH WAS GENERATED TO ENABLE A SIGNIFICANT REDUCTION IN BANK DEBT. A FURTHER REDUCTION OF BANK DEBT IS ANTICIPATED IN 1986, PRIMARILY IN THE DECEMBER QUARTER.

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UNITED STATES

THE U.S. CONTRIBUTED \$50 MILLION OF THE CONSOLIDATED 1985 NET LOSS OF \$237 MILLION. TOTAL SOURCES IN THE U.S. WERE A NEGATIVE \$13 MILLION IN 1985. DEPRECIATION AND THE CAPITALIZATION OF INTERCOMPANY BALANCES TO MAINTAIN THE MINIMUM LEVEL OF NET WORTH REQUIRED BY THE U.S. LOAN AGREEMENTS WERE NOT SUFFICIENT TO OFFSET THE NET LOSS. NO CAPITAL CONTRIBUTIONS ARE ANTICIPATED FOR 1986 DUE TO THE EXPECTED RETURN TO PROFITABILITY. WITH THE CLOSING OF COSTA MESA, DEPRECIATION IN 1986 IS EXPECTED TO BE APPROXIMATELY HALF OF THE 1985 LEVEL.

LIKewise, CAPITAL EXPENDITURES ARE EXPECTED TO DECREASE SIGNIFICANTLY IN 1986 TO \$7 MILLION. IN 1985, A REDUCTION IN WORKING CAPITAL PROVIDED A NET SOURCE OF \$59 MILLION, PRIMARILY DUE TO A SIGNIFICANT REDUCTION IN INVENTORIES OFFSET BY A REDUCTION IN INTERCOMPANY PAYABLES. IN 1986 WORKING CAPITAL IS FORECAST TO RESULT IN A SMALL SOURCE OF \$12 MILLION. NET CASH FLOW OF \$23 MILLION IN 1986 IS EXPECTED FROM OPERATIONS, IN CONTRAST TO LAST YEAR'S CASH FLOW, WHICH WAS PRIMARILY PRODUCED BY REQUIRED CAPITAL CONTRIBUTIONS.

Cash Flow

Germany

\$ In Millions	<u>1985</u>	<u>1986</u>
<u>Sources</u>		
Net Income	\$ (1)	\$ 3
Depreciation	1	1
Total Sources	<u>-</u>	<u>4</u>
<u>Uses</u>		
Capital Expenditures	(2)	(1)
Dividend	-	(6)
Working Capital	7	1
Other, Net	(2)	-
Total Uses	<u>3</u>	<u>(6)</u>
Net Cash Flow	<u>\$ 3</u>	<u>\$ (2)</u>

Cash Flow

United Kingdom

\$ In Millions	<u>1985</u>	<u>1986</u>
<u>Sources</u>		
Net Income	\$ (9)	\$ (2)
Depreciation	1	1
Total Sources	<u>(8)</u>	<u>(1)</u>
<u>Uses</u>		
Capital Expenditures	(3)	-
Working Capital	5	6
Other, Net	2	(1)
Total Uses	<u>4</u>	<u>5</u>
Net Cash Flow	<u>\$ (4)</u>	<u>\$ 4</u>

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THE POSITIVE CASH FLOW IN BOTH 1985 AND 1986 IS EXPECTED TO BE USED TO REDUCE INDEBTEDNESS.

UNITED KINGDOM

DECLINING INVENTORIES SHOULD LOWER FORECAST LOSSES IN THE U.K. AND RESULT IN AN IMPROVED BUT NOMINALLY NEGATIVE SOURCE OF FUNDS IN 1986. HOWEVER, LOWER INVENTORIES WILL PROVIDE A SOURCE OF FUNDS FROM WORKING CAPITAL, WHICH SHOULD MORE THAN OFFSET THE FUNDS USED IN OPERATIONS. IN 1985, THE NET CASH FLOW DEFICIT OF \$4 MILLION WAS FINANCED BY BANK DEBT.

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GERMANY

IN 1985, GERMANY'S OPERATIONS PROVIDED NO FUNDS AND THE NET CASH FLOW OF \$3 MILLION PRIMARILY REFLECTED A REDUCTION IN WORKING CAPITAL. THE NET CASH FLOW OF \$3 MILLION WAS USED TO REPAY BANK DEBT.

IN 1986, NET INCOME AND DEPRECIATION ARE FORECAST AT \$4 MILLION. NET WORKING CAPITAL IS AGAIN EXPECTED TO BE A SOURCE BUT WILL BE OFFSET BY A PLANNED PAYMENT OF A \$6 MILLION DIVIDEND TO THE PARENT COMPANY IN MARCH, WHICH IS REQUIRED BY GERMAN TAX LAW TO MINIMIZE TAXES PAYABLE. THE NET CASH DEFICIT OF \$2 MILLION WILL BE FINANCED BY BANK DEBT UNDER AVAILABLE CREDIT FACILITIES.

NOW TOM RATTIGAN WILL REVIEW THE RESULTS FOR THE DECEMBER 1985 QUARTER AND THE OUTLOOK FOR 1986 AND BEYOND.

Operating Results

\$ In Millions	4th Quarter 1985
Revenues	\$339
Variable Costs-Standard	241
Variable Profit-Standard	98
Margin	29%
Unallocated Variable Costs	43
Variable Profit	55

1985 FOURTH QUARTER

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DECEMBER 1985 QUARTERLY REVENUES OF \$339 MILLION WERE THE SECOND HIGHEST IN THE COMPANY'S HISTORY AND WERE ON TARGET WITH THE PLAN GIVEN TO THE BANKS LAST AUGUST. REVENUES OF \$145 MILLION FOR THE C64 PRODUCT GROUP WERE 25% ABOVE PLAN, AND SALES OF \$125 MILLION FOR THE C128 GROUP WERE ALSO ABOVE PLAN (\$11MM). DUE TO THE LIMITED AVAILABILITY OF SOFTWARE, AMIGA SALES OF \$36 MILLION WERE BELOW PLAN (\$23MM). OTHER PRODUCTS INCLUDING THE PC 10/20, ACCOUNTED FOR THE REMAINING \$33 MILLION OF REVENUES.

THE WEAKENING OF THE U.S. DOLLAR AGAINST MAJOR EUROPEAN CURRENCIES, PRIMARILY THE GERMAN MARK AND THE BRITISH POUND, HAD A FAVORABLE IMPACT ON BOTH REVENUES (\$8-20MM) AND VARIABLE MARGIN. TOTAL VARIABLE MARGIN FOR THE QUARTER WAS \$98 MILLION, OR 29% OF SALES. THIS MARKED THE SECOND STRAIGHT QUARTER OF IMPROVING MARGINS.

MAJOR UNALLOCATED VARIABLE COSTS INCLUDED \$24 MILLION IN INVENTORY WRITEDOWNS AND \$10 MILLION OF AIR FREIGHT (UNABSORBED LABOR/REWORK THE BALANCE). AN INITIAL RESERVE OF \$25 MILLION WAS TAKEN FOR TED FINISHED GOODS IN JUNE 1985. SINCE THAT TIME, TED SALES HAVE TOTALED \$22 MILLION, AND HAVE BEEN CONTRIBUTING TO OUR IMPROVED INVENTORY POSITION. WHILE ONGOING ORDERS HAVE BEEN RECEIVED FOR THE C16, SALES OF THE HIGHER-PRICED PLUS 4 HAVE BEEN WEAK IN ALL COUNTRIES EXCEPT THE UNITED KINGDOM. SO, AT THE END OF THE CHRISTMAS SELLING SEASON, A COMPREHENSIVE REVIEW WAS MADE OF THE EXISTING INVENTORY OF TED AND OTHER DISCONTINUED PRODUCTS. AS A RESULT OF THAT REVIEW, IT WAS DETERMINED THAT AN ADDITIONAL TED WRITEDOWN OF \$5 MILLION WAS PRUDENT, (NET REMAINING VALUE OF TED INVENTORY AT \$12 MILLION).

IN ADDITION, THE GROWTH OF PC 10/20 SALES (\$33MM) IN THE LAST HALF OF 1985 HAD THE ADVERSE EFFECT OF MAKING THE PET BUSINESS SYSTEMS LESS MARKETABLE IN EUROPE. ACCORDINGLY, A WRITEDOWN OF \$11 MILLION WAS TAKEN, RATHER THAN INVESTING IN REQUIRED PARTS TO BUILD OUT COMPLETE PRODUCT. AND, FINALLY, CERTAIN DEFECTIVE AND/OR SLOW-MOVING ITEMS, SUCH AS SOFTWARE AND PRINTERS, WERE SOLD AT GREATER LOSSES THAN ORIGINALLY ESTIMATED IN JUNE, RESULTING IN ADDITIONAL WRITEDOWNS OF \$8 MILLION. AFTER THIS TOTAL WRITEDOWNS OF \$24 MILLION, MANAGEMENT BELIEVES THAT INVENTORIES ARE REALISTICALLY STATED AT MINIMAL NET REALIZABLE VALUE.

ALTHOUGH MOST TECHNICAL AND PROCUREMENT HURDLES FOR THE AMIGA AND C128 WERE OVERCOME BEFORE THE IMPORTANT CHRISTMAS SELLING SEASON, PRODUCTION DELAYS NECESSITATED THE USE OF AIR FREIGHT TO A GREATER EXTENT THAN HAD BEEN PLANNED. A LARGE PORTION OF THE TOTAL AIR FREIGHT COST (\$10 MILLION FOR THE QUARTER), RELATED TO BULKY ITEMS LIKE DISK DRIVES MONITORS, AND CPU'S, WHICH ARE ESPECIALLY EXPENSIVE TO SHIP BY AIR.

EVEN AFTER THE INVENTORY WRITEDOWNS THE VARIABLE PROFIT OF \$55 MILLION WAS THE HIGHEST SINCE THE DECEMBER, 1984 QUARTER.

Unusual Items

\$ In Millions	4th Quarter 1985
Costa Mesa Shutdown	\$19
Corby Manufacturing Shutdown	3
TED Inventory Writedown	5
PET Inventory Writedown	11
Defective/ Obsolete Peripherals and Software	8
Barter Credit Writedown	5
Total Unusual Items	<u>\$51</u>

Operating Results

\$ In Millions	4th Quarter 1985
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Revenues	\$339
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Variable Profit	55
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Fixed Expenses	<u>105</u>
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Pre-Tax Income	(50)
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Income Taxes	<u>3</u>
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Net Income	<u><u>\$ (53)</u></u>
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Pre-Tax Income Excluding	
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Unusual Items	<u><u>\$ 1</u></u>
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TOTAL FIXED EXPENSES FOR THE QUARTER WERE \$105 MILLION, AND INCLUDE \$22 MILLION IN RESTRUCTURING CHARGES ASSOCIATED WITH THE CLOSING OF THE SEMICONDUCTOR MANUFACTURING PLANT IN COSTA MESA, CALIFORNIA AND DISCONTINUANCE OF COMPUTER ASSEMBLY OPERATIONS IN THE U.K. AT COSTA MESA, \$14 MILLION OF UNUSABLE EQUIPMENT WAS WRITTEN DOWN. AN ADDITIONAL PROVISION OF \$5 MILLION WAS MADE FOR THE COSTS TO BE INCURRED (IN 1986) TO COMPLETE THE WORK IN PROCESS INVENTORY, TO MAINTAIN THE BUILDING UNTIL THE LEASE EXPIRES, AND TO MOVE CERTAIN EQUIPMENT TO THE REMAINING SEMICONDUCTOR FACILITY IN VALLEY FORGE, PENNSYLVANIA. AT CORBY, THE \$3 MILLION CLOSING COSTS INCLUDED \$800,000 FOR REPAYMENT OF A REGIONAL DEVELOPMENT GRANT, AND A WRITEDOWN OF BUILDING AND EQUIPMENT. AFTER THE WRITEDOWN, THE CORBY BUILDING IS CARRIED ON THE BOOKS AT AN APPRAISED VALUE OF \$4 MILLION.

THE FINAL UNUSUAL ADJUSTMENT IN THE DECEMBER QUARTER WAS A WRITEDOWN OF \$5 MILLION FOR CERTAIN BARTER CREDITS WHICH ARE EXPECTED TO BE SOLD AT A DISCOUNT. EFFORTS ARE UNDERWAY TO MONETIZE THESE CREDITS, WHICH WERE RECEIVED OVER A YEAR AGO FROM THE SALE OF DISCONTINUED PRODUCTS.

IN SUMMARY, THE TOTAL CASH PORTION OF ALL THE UNUSUAL ADJUSTMENTS WAS \$6 MILLION, OR APPROXIMATELY 12% OF THE TOTAL WRITEDOWN.

EXCLUDING THE UNUSUAL WRITEDOWNS FOR RESTRUCTURING, INVENTORY, AND BARTER CREDITS, PRETAX INCOME FROM ONGOING OPERATIONS WAS \$1 MILLION FOR THE QUARTER VERSUS A PLAN OF \$6 MILLION. SINCE A NUMBER OF OFFSHORE SUBSIDIARIES WERE PROFITABLE, A SMALL INCOME TAX PROVISION WAS MADE. AND, AS YOU CAN SEE, AFTER UNUSUAL ITEMS, THE NET LOSS WAS \$53 MILLION.

FOR CALENDAR YEAR 1985, NET SALES WERE ALMOST \$800 MILLION, WITH THE DECEMBER QUARTER ACCOUNTING FOR 42% OF THE YEAR'S SALES AND COMPARING FAVORABLY TO THE YEAR AGO QUARTER. HOWEVER, LOSSES WERE RECORDED IN ALL FOUR QUARTERS OF 1985 DUE TO DISCOUNTED BUNDLE PRICING TO LIQUIDATE OVERSTOCKED PERIPHERALS, INVENTORY WRITEDOWNS (\$91MM), PLANT CLOSING COSTS (\$25MM), AND NEW PRODUCT INTRODUCTION COSTS. THE GOAL OF REDUCING WORLDWIDE INVENTORIES BY MORE THAN 50% FROM THE DECEMBER 1984 LEVEL WAS ACHIEVED, BUT THE COSTS WERE HIGH. HOWEVER, SIGNIFICANT CASH WAS GENERATED AND THE SALEABILITY OF REMAINING INVENTORY WAS GREATLY IMPROVED BASED ON A SHIFT IN MIX TO NEW PRODUCTS.

WITH HIGHER QUALITY INVENTORY, IMPROVED PURCHASING, EXPENSE REDUCTIONS AND BETTER VARIABLE MARGINS, WE STRONGLY BELIEVE THAT PROFITABILITY CAN BE RESTORED IN 1986.

Unit Volume

Unit Volume (000's)	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Year</u>
United States	147	149	155	225	676
United Kingdom	26	19	21	26	92
Germany	64	57	63	100	284
Other	<u>143</u>	<u>132</u>	<u>114</u>	<u>177</u>	<u>566</u>
Total Unit Volume	380	357	353	528	1,618

1986 - Quarterly Review

\$ In Millions	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Year</u>
Unit Volume (000's)	380	357	353	528	1,618

1986 - QUARTERLY REVIEW

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AS A RESULT OF THE SHIFT TO HIGHER PRICED PRODUCTS, CPU UNIT VOLUME IS EXPECTED TO BE DOWN RELATIVE TO 1985. IN THE FIRST QUARTER, UNIT SALES OF THE C64 AND C128 ARE EXPECTED TO ACCOUNT FOR 90% OF TOTAL CPU'S, FUELED TO SOME EXTENT BY A CARRYOVER OF C64 DEMAND FROM THE 1985 CHRISTMAS SEASON AND FIRST-HALF PROMOTIONAL EFFORTS ON THE C128. AMIGA'S PERCENT OF TOTAL CPU SALES IS PROJECTED TO INCREASE IN EACH QUARTER, PEAKING AT 20% OF TOTAL CPU SALES IN THE DECEMBER QUARTER, AS MORE SOFTWARE TITLES AND THE IBM COMPATIBILITY OPTION BECOME AVAILABLE. ALSO FUELING AMIGA GROWTH WILL BE THE EUROPEAN LAUNCH SCHEDULED FOR SPRING, 1986.

Revenues

\$ in Millions	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Year</u>
United States	\$ 75	\$ 95	\$ 95	\$140	\$405
United Kingdom	10	10	11	14	45
Germany	24	28	31	52	135
Other	<u>61</u>	<u>62</u>	<u>53</u>	<u>94</u>	<u>270</u>
Total Revenues	\$170	\$195	\$190	\$300	\$855

1986 - Quarterly Review

\$ In Millions	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Year</u>
Unit Volume (000's)	380	357	353	528	1,618
Revenues	\$170	\$195	\$190	\$300	\$855

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BECAUSE OF THE ANNUALIZATION OF AMIGA SALES, AND THE FACT THAT EACH UNIT OF THE AMIGA CURRENTLY GENERATES OVER 5 TIMES AS MUCH REVENUE AS EACH C64, AMIGA VOLUME GROWTH IS PROJECTED TO BE THE PRIMARY CONTRIBUTOR TO OVERALL REVENUE GROWTH. AMIGA IS EXPECTED TO ACCOUNT FOR 45% OF TOTAL REVENUES IN THE DECEMBER QUARTER. HIGHER-PRICED CPU'S SUCH AS THE AMIGA AND THE PC 10/20 SHOW LESS SEASONAL VOLUME VARIANCES THAN LOWER-PRICED CPU'S. THEREFORE, REVENUES FOR THE DECEMBER QUARTER ARE PROJECTED TO INCREASE ONLY 60% OVER THE SEPTEMBER QUARTER, VERSUS THE 100% GROWTH EXPERIENCED IN 1985 WHEN THE C64 AND C128 PROVIDED THE BULK OF REVENUES. REVENUE GROWTH IN THE U.S. WILL ACCOUNT FOR ALMOST ALL OF THE COMPANY'S GAIN IN 1986 VERSUS 1985.

Variable Profit

\$ In Millions	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Year</u>
United States	\$18	\$25	\$26	\$40	\$109
United Kingdom	1	2	2	2	7
Germany	5	6	7	11	29
Other	28	30	25	51	134
Total Variable Profit	\$52	\$63	\$60	\$104	\$279

1986 - Quarterly Review

\$ In Millions	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Year</u>
Unit Volume (000's)	380	357	353	528	1,618
Revenues	\$170	\$195	\$190	\$300	\$855
Variable Profit	52	63	60	104	279
Margin	30%	33%	32%	35%	33%

- SLIDE LEFT -

- SLIDE RIGHT -

VARIABLE PROFIT IS PROJECTED TO INCREASE EACH QUARTER AT A RATE PROPORTIONAL TO THE INCREASE IN REVENUES, DELIVERING A RELATIVELY CONSTANT 33% MARGIN FOR THE YEAR VERSUS A 4% MARGIN IN 1985. MODEST PRICE REDUCTIONS IN THE LAST HALF OF 1986 ARE EXPECTED TO BE OFFSET BY COMPARABLE COST REDUCTION PROGRAMS CURRENTLY BEING COMPLETED, SUCH AS THE SAVINGS RESULTING FROM RETRENCHED SEMICONDUCTOR MANUFACTURING AND ASSEMBLY OPERATIONS.

Net Income

\$ In Millions	<u>3/ 86</u>	<u>6/ 86</u>	<u>9/ 86</u>	<u>12/ 86</u>	<u>Year</u>
United States	\$ (4)	-	-	\$ 10	\$ 6
United Kingdom	(1)	(1)	-	-	(2)
Germany	-	-	1	2	3
Other	-	5	1	15	21
Total Net Income	<u>\$ (5)</u>	<u>\$ 4</u>	<u>\$ 2</u>	<u>\$ 27</u>	<u>\$ 28</u>

1986 - Quarterly Review

\$ In Millions	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Year</u>
Unit Volume (000's)	380	357	353	528	1,618
Revenues	\$170	\$195	\$190	\$300	\$855
Variable Profit	52	63	60	104	279
Margin	30%	33%	32%	35%	33%
Net Income	(5)	4	2	27	28

- SLIDE LEFT -

- SLIDE RIGHT -

COMMODORE WILL RETURN TO PROFITABILITY IN 1986 DESPITE A LOSS OF \$5 MILLION IN THE FIRST QUARTER. THE \$9 MILLION IMPROVEMENT IN THE JUNE QUARTER VERSUS MARCH IS DUE TO THE PROJECTED DOUBLING OF VOLUME FOR AMIGA. AS HISTORICALLY HAS BEEN THE CASE, THE DECEMBER QUARTER IS THE MOST PROFITABLE PERIOD BECAUSE THE VARIABLE PROFIT ASSOCIATED WITH INCREMENTAL VOLUME IS MUCH GREATER THAN THE INCREASE IN OPERATING EXPENSES. THE INCREASE IN 1986 NET INCOME IS TOTALLY ATTRIBUTABLE TO PROFIT IN CEL (\$198MM) AND THE U.S. (\$56MM).

Net Cash Flow

\$ in Millions	<u>3 / 86</u>	<u>6 / 86</u>	<u>9 / 86</u>	<u>12 / 86</u>	<u>Year</u>
United States	\$6	\$2	\$2	\$13	\$23
United Kingdom	1	-	-	3	4
Germany	(3)	-	-	1	(2)
Other	<u>4</u>	<u>2</u>	<u>1</u>	<u>5</u>	<u>12</u>
Total Net Cash Flow	\$8	\$4	\$3	\$22	\$37

1986 - Quarterly Review

\$ In Millions	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Year</u>
Unit Volume (000's)	380	357	353	528	1,618
Revenues	\$170	\$195	\$190	\$300	\$855
Variable Profit	52	63	60	104	279
Margin	30%	33%	32%	35%	33%
Net Income	(5)	4	2	27	28
Net Cash Flow	8	4	3	22	37

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- SLIDE RIGHT -

POSITIVE CASH FLOW IS FORECAST FOR EACH QUARTER IN 1986, WITH 2/3 BEING GENERATED IN THE U.S. DEPRECIATION AND AMORTIZATION, THE ONLY NON-CASH CHARGES DURING THE YEAR, ARE PROJECTED TO BE \$8 MILLION PER QUARTER. CAPITAL EXPENDITURES ARE FORECAST TO BE EVENLY SPREAD THROUGHOUT THE YEAR AT \$3-4 MILLION PER QUARTER. DURING THE FIRST QUARTER, A DECREASE IN ACCOUNTS RECEIVABLE, OFFSET BY OTHER CHANGES IN WORKING CAPITAL, IS EXPECTED TO GENERATE A POSITIVE CASH FLOW OF \$8 MILLION. IT IS ANTICIPATED THAT CASH FLOW FOR THE SECOND AND THIRD QUARTERS WILL BE marginally positive with a MAJOR INCREASE TO \$22 MILLION IN THE FOURTH QUARTER. IT IS PLANNED THAT CUMULATIVE NET CASH FLOW OF \$37 MILLION WILL BE APPLIED TO REDUCE DEBT.

IN SUMMARY, WE BELIEVE THAT THE FORECAST SALES VOLUMES ARE VERY CONSERVATIVE... PARTICULARLY FOR THE C64/C128 FAMILY AND, POTENTIALLY, ON THE PC PRODUCT LINE AS WELL. WHILE THERE ARE ALWAYS BUSINESS RISKS, THE PROBABILITY OF ACHIEVING THESE REVENUES IS VERY HIGH. THE INCOME STATEMENT HAS ALSO BEEN PREPARED ON A CONSERVATIVE BASIS AS SEVERAL COST REDUCTION PROGRAMS WHICH ARE UNDERWAY HAVE NOT BEEN REFLECTED IN THE FORECAST. THESE PROGRAMS SHOULD YIELD BENEFITS IN THE LATTER HALF OF 1986 AND IN 1987.

Forward Outlook

- Product Strategy

FORWARD OUTLOOK

- SLIDE LEFT -

COMMODORE'S LONG-TERM SUCCESS IS DEPENDENT UPON TWO KEY FACTORS:

- 1) QUALITY PRODUCTS WHICH MAINTAIN OUR PRICE/VALUE LEADERSHIP AND
- 2) COST REDUCTION THROUGH RATIONALIZATION OF MANUFACTURING AND THE SALES COMPANIES

WHILE 1985 WAS A YEAR OF MAJOR PRODUCT INTRODUCTIONS, IN 1986 COMMODORE WILL REALIZE THE BENEFIT OF THE ANNUALIZATION AND GEOGRAPHIC EXPANSION OF THOSE LAUNCHES. THE PRIMARY PRODUCT FOCUS WILL BE ON ENHANCEMENTS AND LINE EXTENSIONS OF THESE PRODUCTS WHICH WILL IMPROVE OUR COMPETITIVE STRENGTH IN THE MARKETPLACE.

FOR BOTH THE C64 AND C128, THE FOCUS FOR 1986 AND BEYOND WILL BE ON PROVIDING NEW MACHINE FEATURES OR ENHANCEMENTS. FOR EXAMPLE, A C128 UNIT WITH A BUILT-IN DISK DRIVE AND DETACHABLE KEYBOARD HAS JUST BEEN LAUNCHED IN EUROPE. PENDING COST THIS CPU HAS REAL VIABILITY IN THE U.S. MARKET AS A COMPETITOR TO THE APPLE IIC. THE C64 WILL BE REHOUSED IN A SLEEKER, MORE MODERN CASE IN THE JUNE QUARTER. IN ADDITION, ALL C64/128 PRODUCT WILL BE BUNDLED WITH A NEW DISK OPERATING SYSTEM WHICH PROVIDES ICONS, MENUS AND WINDOWS, IS CONTROLLED BY A MOUSE OR JOYSTICK, AND WILL INCLUDE WORD PROCESSING AND GRAPHIC APPLICATIONS COMPARABLE TO COMPETITIVE MACINTOSH PRODUCTS. THIS PRODUCT ENHANCEMENT, TARGETED FOR A JUNE QUARTER INTRODUCTION, DRAMATICALLY IMPROVES THE EASE-OF-USE AND FUNCTIONALITY OF THE LINE, AND WILL ALLOW THE EDUCATIONAL MARKET TO UPGRADE ITS ENTIRE C64 INSTALLED BASE. COMMODORE WILL ALSO MARKET A NUMBER OF IMPORTANT PERIPHERALS, INCLUDING 128K AND 512K RAM MEMORY EXPANSION CARTRIDGES, AND AN 800K 3 1/2" EXTERNAL DRIVE.

THUS, IN ADDITION TO OUR SHIFT TOWARD HIGHER-TICKET CPU'S, WHICH CORRESPONDS TO CURRENT MARKET TRENDS, WE HAVE ALSO TAKEN STEPS TO ENSURE THE C64'S CONTINUED VITALITY AS THE BEST ENTRY-LEVEL SYSTEM ON THE MARKET.

OUR PC COMPATIBLE PRODUCT WILL BE LAUNCHED IN THE U.S. IN THE JUNE QUARTER. WE CONSERVATIVELY ESTIMATE THAT THE MARKET FOR IBM PC AND PC CLONES IN 1985 WAS 2.3 MILLION UNITS IN THE U.S., AND WILL REACH 3 MILLION IN 1986. BASED ON THE SUCCESS OF VENDORS SUCH AS TANDY AND OTHERS IN TARGETING THIS GROWING SEGMENT, WE ARE NOW PREPARED TO ENTER THIS MARKET IN A LIMITED CHANNEL BASIS WITH A COMPETITIVELY-PRICED MACHINE THAT HAS ALREADY PROVEN ITS ACCEPTANCE IN THE EUROPEAN MARKET. TO ENHANCE OUR PC POSITION IN BOTH MARKETS, WE ARE CURRENTLY DEVELOPING A PC WITH BUILT-IN 3 1/2" DRIVES AND A PC AT CLONE FOR INTRODUCTION INTO THE EUROPEAN MARKET AT MID-YEAR.

THE MOST SIGNIFICANT NEW PRODUCT DEVELOPMENT WILL BE AN AMIGA UPGRADE TARGETED AT THE CORPORATE AND PROFESSIONAL MARKET SEGMENTS. THE NEW CPU WILL HAVE EXPANDED MEMORY, BUILT-IN EXPANSION SLOTS AND AN OPTIONAL 20 MEGA BYTE HARD DISK. ANOTHER FEATURE OF THE UPGRADED AMIGA WILL BE AN IBM PC HARDWARE OPTION. AN AMIGA CPU WITH THESE FEATURES WILL ENSURE CONTINUED RETAIL DISTRIBUTION GAINS AND SUBSTANTIALLY IMPROVE OUR ACCEPTANCE IN THE CORPORATE MARKETPLACE.

Forward Outlook

- Product Strategy
- Cost Reduction Plan

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IN 1986, WE WILL REALIZE THE BENEFITS OF EXTENSIVE COST REDUCTION PROGRAMS CARRIED OUT DURING THE LAST SEVEN MONTHS. THESE INCLUDED A REDUCTION IN THE NUMBER OF NORTH AMERICAN PERSONNEL, THE SALE OF ONE UNPROFITABLE CANADIAN OPERATION, AND THE CLOSING OF FACILITIES IN COSTA MESA AND THE UNITED KINGDOM.

DURING THE COMING YEAR, WE WILL TAKE FURTHER COST REDUCTION MEASURES. THESE INCLUDE THE RESTRUCTURING AND RATIONALIZATION OF THE EUROPEAN SALES COMPANIES, AND THE CONSOLIDATION OF WORLDWIDE MANUFACTURING AND ASSEMBLY OPERATIONS. IN ADDITION, WE WILL CENTRALIZE THE WORLDWIDE PURCHASING FUNCTION UNDER A NEW VICE PRESIDENT OF PROCUREMENT. THIS INDIVIDUAL WILL BE RESPONSIBLE FOR COORDINATING ALL WORLDWIDE CONTRACT NEGOTIATIONS TO SECURE THE LOWEST POSSIBLE COSTS AND THE BEST PAYMENT TERMS. QUALITY STANDARDS FOR ALL PURCHASED COMPONENTS ARE BEING REVIEWED AND, WITH ADDITIONAL IN-HOUSE IMPROVEMENTS IN QUALITY CONTROL, WE EXPECT TO REDUCE OUR REWORK COSTS SUBSTANTIALLY.

IN CONJUNCTION WITH A STRENGTHENING OF THE PURCHASING FUNCTION, WE CONTINUE TO TIGHTLY CONTROL AND MANAGE OUR WORLDWIDE INVENTORY. INVENTORY LEVELS HAVE ALREADY BEEN SIGNIFICANTLY REDUCED DURING THE PAST 12 MONTHS. WITH CONTINUING TIGHT MANAGEMENT, OUR INVENTORY TURNOVER WILL INCREASE TO 3.5 TIMES IN 1986.

IN THE AREA OF OPERATING EXPENSES FOR THE MARKETING COMPANIES, SUBSTANTIAL SAVINGS WILL BE REALIZED BY MEANS OF GREATER CONTROL AND MANAGEMENT ACCOUNTABILITY. STRICT TARGETS HAVE BEEN ESTABLISHED FOR ALL SUBSIDIARIES, AND MONTHLY SENIOR MANAGEMENT MEETINGS WILL BE HELD TO TAKE IMMEDIATE CORRECTIVE ACTIONS FOR ANY UNFAVORABLE VARIANCES FROM PLAN.

ANOTHER AREA TARGETED FOR EXPENSE REDUCTION IS MARKETING. WITH ADVERTISING AND MERCHANDISING EXPENSES PLANNED AT 8.8% OF REVENUES IN 1986, VERSUS THE 1985 PERCENTAGE OF 10.8%, EXPENSE SAVINGS OF \$17 MILLION SHOULD BE ACHIEVED.

WE ARE ALSO CONSOLIDATING THE EUROPEAN SALES, WAREHOUSE, AND DISTRIBUTION OPERATIONS. THE EUROPEAN SALES AND ADMINISTRATIVE FUNCTIONS ARE BEING RESTRUCTURED, WITH A TOTAL PLANNED MANPOWER REDUCTION OF 39%, OR 240 PEOPLE, BY MID-1986 AND ANNUALIZED SAVINGS OF OVER \$3 MILLION. THIS ACTION, PLUS A MAJOR MANPOWER REDUCTION IN THE U.S. AND CANADIAN SALES COMPANIES TAKEN IN MID-1985, WILL RESULT IN A TOTAL MANPOWER REDUCTION OF OVER 400 PEOPLE YIELDING AN ANNUALIZED SAVINGS OF OVER \$7 MILLION.

WITH AN EXPENDITURE OF \$35 MILLION OF R&D IN 1986, WE WILL BE ABLE TO MAINTAIN OUR COMPETITIVE TECHNOLOGY LEAD DESPITE REDUCTIONS IN R&D HEADCOUNT AND R&D-RELATED EXPENSES THAT WILL RESULT IN ADDITIONAL SAVINGS OF \$18 MILLION VERSUS 1985.

ON AN ANNUALIZED BASIS, THESE COST ACTIONS ALONE WILL RESULT IN A SAVINGS OF OVER \$40 MILLION, CONTRIBUTING SIGNIFICANTLY TO THE COMPANY'S RETURN TO PROFITABILITY IN 1986.

Forward Outlook

- Product Strategy
- Cost Reduction Plan
- Long Term Competitive Considerations

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OUR LONGER TERM COMPETITIVE OUTLOOK DEPENDS UPON TWO IMPORTANT FACTORS: 1) COMPETITIVE ACTIONS AND 2) DISTRIBUTION CHANNELS.

AT THE COMPETITIVE LEVEL, THERE ARE OBVIOUSLY A NUMBER OF COMPANIES INCLUDING APPLE, TANDY, COMPAQ, AND OLIVETTI, WHICH COULD POTENTIALLY HAVE AN IMPACT ON COMMODORE'S PRODUCT STRATEGY. HOWEVER, NONE OF THESE COMPANIES IS A DIRECT THREAT TO COMMODORE'S SURVIVAL. IBM IS A SPECIAL CASE BECAUSE OF THE CONTINUING TREND TOWARD STANDARDIZATION AROUND THE MS/DOS OPERATING SYSTEM IN THE BUSINESS ARENA. WITH THE IBM-COMPATIBLE HARDWARE OPTION, AND THE ENHANCED FEATURES OF THE AMIGA UPGRADE, WE ARE CONFIDENT THAT WE CAN COMPETE SUCCESSFULLY FOR A SHARE OF THE IBM COMPATIBLE UNIVERSE.

IN THE HOME MARKET WE DO NOT BELIEVE THAT THE IBM MS/DOS SYSTEM IS AN APPROPRIATE STANDARD DUE TO PRICE POINT, LIMITED GRAPHICS AND SOUND CAPABILITIES, BUSINESS-ORIENTED SOFTWARE BASE, AND HIGH-END DISTRIBUTION. IN VIEW OF IBM'S HIGH MARGIN CRITERIA AND POOR EXPERIENCE WITH THE PCJR, WE DO NOT VIEW THEM AS A SERIOUS IMMEDIATE THREAT TO COMMODORE IN THE LOW-END MARKET.

THE MAJOR JAPANESE CONSUMER ELECTRONICS COMPANIES ARE PROBABLY THE MOST SERIOUS LONG-TERM COMPETITIVE THREAT, IF THEY CAN MAINTAIN THE COHESIVE APPROACH THAT FOSTERED MSX I & II. AT PRESENT, THERE IS NO AGREEMENT WITHIN THE CONSORTIUM ON THE DESIGN SPECIFICATIONS OF A MORE POWERFUL, BUT UPWARDLY COMPATIBLE MSX III. HOWEVER, WE BELIEVE THAT COMMODORE WILL BE AN EFFECTIVE COMPETITOR DUE TO OUR WORLDWIDE MARKETING EXPERTISE.

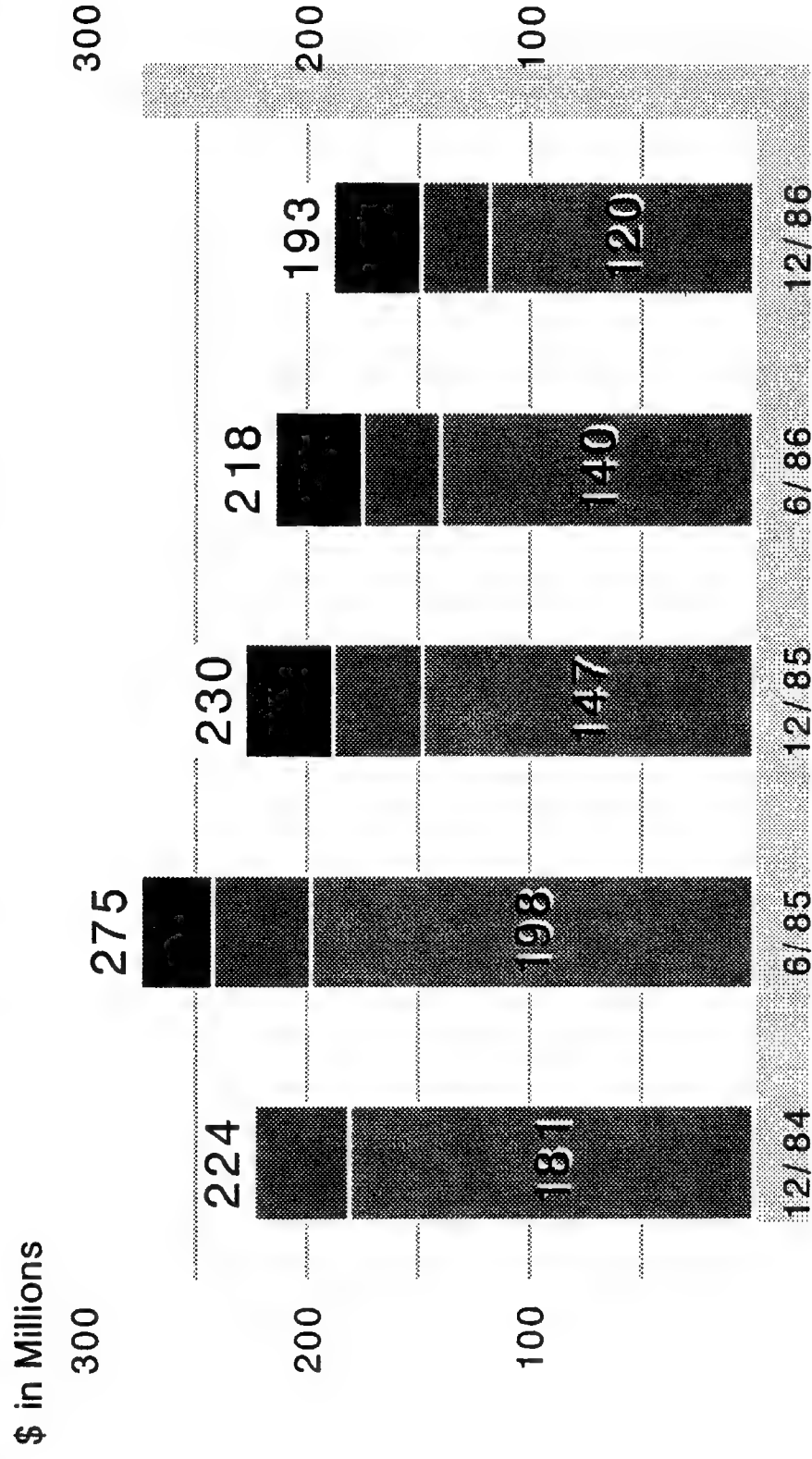
RELATIVE TO DISTRIBUTION, COMMODORE CONTINUES TO DOMINATE THE MASS MARKET CHANNEL. WE DON'T ANTICIPATE ANY SIGNIFICANT COMPETITION OR SHARE EROSION IN THIS CHANNEL, NOR DO WE EXPECT ANY LARGE-SCALE CONTRACTION IN OUR CURRENT NUMBER OF RETAIL OUTLETS. OUR NEW PRODUCT PLANS, TOGETHER WITH IMPROVING RETAIL MARGINS, WILL MAINTAIN AND STRENGTHEN OUR PRESENCE IN THESE OUTLETS.

WITH COMMODORE'S REENTRY INTO THE LARGER DOLLAR VOLUME COMPUTER SPECIALTY CHANNEL, THE COMPANY IS NOW THE ONLY WORLDWIDE VENDOR WITH A VIABLE PRESENCE IN BOTH MAJOR DISTRIBUTION CHANNELS.

NOW JOHN KELLY WILL DISCUSS WORKING CAPITAL, ASSET COVER, CAPITAL STRUCTURE AND THE CREDIT REQUEST.

Total Debt

Bank Debt
 Leases & Mortgages
 DM Issue



TOTAL DEBT

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AT YEAR-END 1984, TOTAL DEBT AMOUNTED TO \$224 MILLION, CONSISTING OF \$181 MILLION IN BANK DEBT AND \$43 MILLION IN CAPITALIZED LEASES AND MORTGAGES. DURING THE SECOND QUARTER OF 1985, COMMODORE ISSUED PUBLIC DEBT IN GERMANY, DENOMINATED IN DEUTSCHE MARKS, WITH A U.S. DOLLAR EQUIVALENT OF \$33 MILLION. THIS ISSUE, COMBINED WITH AN \$18 MILLION INCREASE IN OTHER DEBT, INCREASED TOTAL DEBT TO A RECORD LEVEL OF \$275 MILLION BY JUNE OF 1985. AS A RESULT OF INVENTORY REDUCTION IN THE LAST HALF OF 1985, TOTAL DEBT IN U.S. DOLLARS DECLINED \$45 MILLION. THIS REDUCTION REFLECTS A \$51 MILLION DECLINE IN BANK DEBT AND A \$1 MILLION REDUCTION IN CAPITALIZED LEASES AND MORTGAGES, PARTLY OFFSET BY A \$7 MILLION INCREASE IN THE DOLLAR VALUE OF THE DEUTCH MARK LIABILITY, DUE TO DEPRECIATION OF THE DOLLAR. TOTAL DEBT IS FORECAST TO BE REDUCED BY \$37 MILLION IN 1986. AT YEAR END 1986, TOTAL DEBT WILL HAVE BEEN REDUCED BY \$82 MILLION, OR ABOUT 30%, SINCE ITS PEAK LEVEL IN MID-1985.

Bank Debt

\$ In Millions	<u>12/84</u>	<u>6/85</u>	<u>12/85</u>	<u>6/86</u>	<u>12/86</u>
United States	\$ 97	\$ 115	\$ 81	\$ 77	\$ 66
United Kingdom	15	23	19	18	15
Germany	16	19	13	16	15
Other	<u>53</u>	<u>41</u>	<u>34</u>	<u>29</u>	<u>24</u>
Total	\$181	\$198	\$147	\$140	\$120

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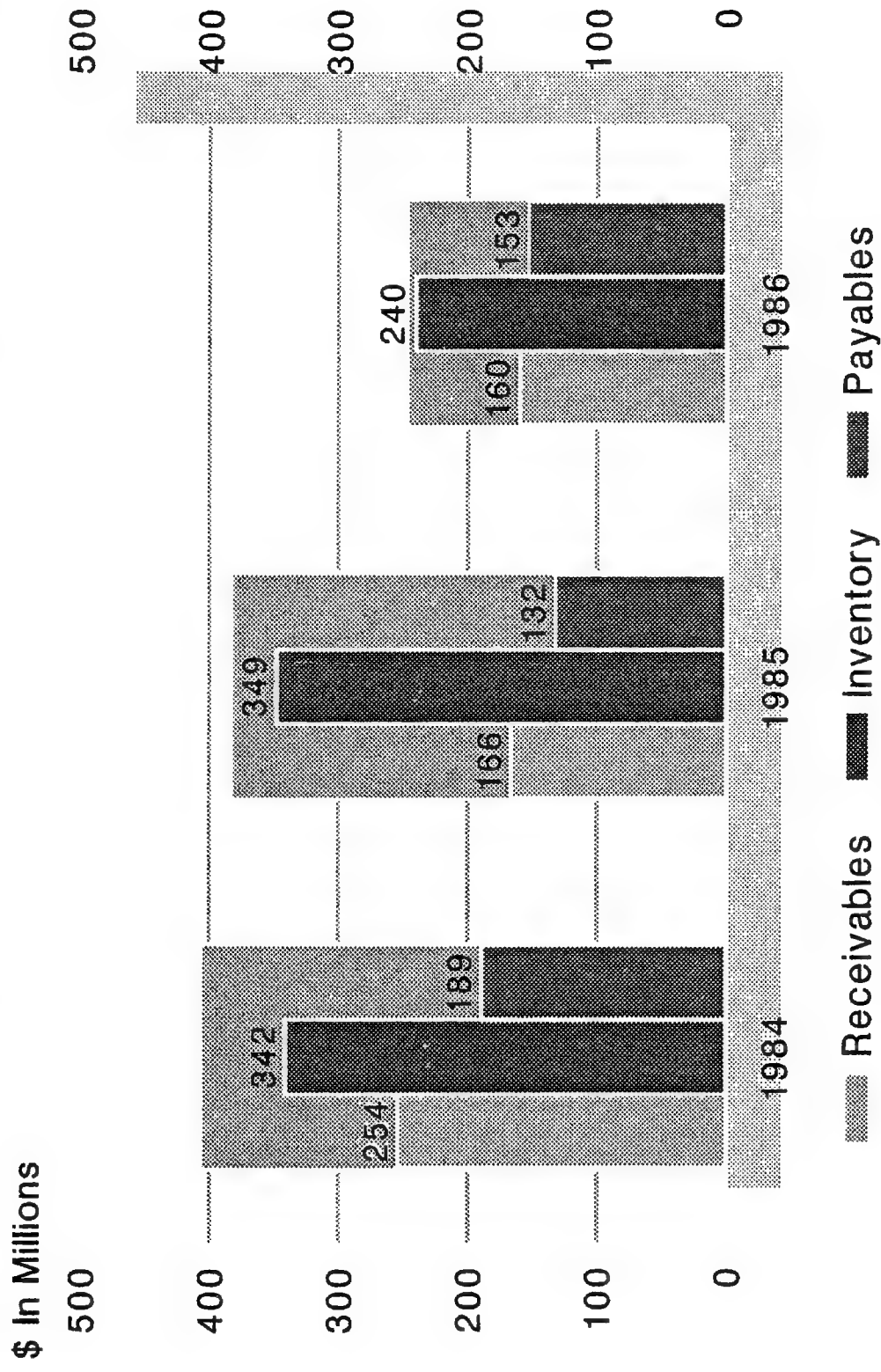
BANK DEBT WAS REDUCED TO \$147 MILLION BY THE END OF 1985 AFTER REACHING A RECORD LEVEL OF \$198 MILLION AT MID-YEAR. REPAYMENTS DURING LATE 1985 WERE MADE ON A PRO-RATA BASIS TO BANKS IN THE U.S., GERMANY, AND THE U.K. NET CASH FLOW IS EXPECTED TO ENABLE A FURTHER 18% OR \$27 MILLION REDUCTION IN BANK DEBT THIS YEAR. REPAYMENTS TOTALLING \$10.5 MILLION HAVE ALREADY BEEN MADE IN 1986, CONSISTING OF \$7.5 MILLION REPAYMENT TO THE BANKS UNDER THE WAIVER AGREEMENT AND AN ADDITIONAL \$3 MILLION IN LOCAL DEBT OF MARKETING SUBSIDIARIES.

BASED ON FORECAST CASH FLOW, FURTHER REDUCTIONS IN BANK DEBT OF APPROXIMATELY \$20 MILLION ARE EXPECTED IN THE FOURTH QUARTER. OF THIS \$20 MILLION REDUCTION, \$15 MILLION WILL BE REPAYED ON A PRO-RATA BASIS TO THE WAIVER BANKS AND \$5 MILLION TO LOCAL BANKS. THIS WOULD RESULT IN BANK DEBT BEING REDUCED BY \$78 MILLION, OR NEARLY 40%, SINCE ITS RECORD HIGH IN JUNE 1985.

Working Capital

	<u>1984</u>	<u>1985</u>	<u>1986</u>
Receivables Days	78	79	68
Inventory Turns	3.5	2.2	3.5
Payable Days	102	82	104

Working Capital



WORKING CAPITAL

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- SLIDE RIGHT -

DURING 1984, TOTAL RECEIVABLES AVERAGED \$254 MILLION, FOR AN AVERAGE OF 78 DAYS OUTSTANDING. RECEIVABLES DECLINED IN 1985 IN LINE WITH THE DECREASE IN SALES, WHILE AVERAGE DAYS WAS STABLE. AVERAGE RECEIVABLES ARE EXPECTED TO DECLINE BY \$6 MILLION IN 1986 WITH AN IMPROVEMENT IN AVERAGE DAYS TO 68, PRIMARILY DUE TO PRODUCT MIX. IN 1986, A PORTION OF U.S. SALES WILL BE TO AMIGA DEALERS WHERE COMMODORE PAYS FOR A FLOOR PLAN FINANCING ARRANGEMENT. UNDER THIS ARRANGEMENT, CASH COLLECTION OCCURS SHORTLY AFTER THE SALE IS MADE.

IN THE U.S., AVERAGE RECEIVABLES DECREASED IN 1985 IN PROPORTION TO THE SALES DECLINE. IN THE U.K. RECEIVABLES DID NOT DECLINE AS MUCH AS SALES IN 1985 AND AVERAGE DAYS WORSENE. THESE RESULTS WERE DUE TO THE PRICE WAR IN THE U.K. IN WHICH COMMODORE'S DEALERS WERE GRANTED LONGER PAYMENT TERMS WHILE THEY TRIED TO REDUCE EXCESS INVENTORY LEVELS. IN GERMANY, AVERAGE DAYS OUTSTANDING HAVE BEEN LEVEL AT 50.

IN 1984, WORLDWIDE INVENTORIES AVERAGED \$342 MILLION, REFLECTING A SHARP BUILDUP FROM \$308 MILLION IN MID-1984 TO A PEAK LEVEL OF \$449 MILLION BY YEAR-END. FOR 1985, AVERAGE INVENTORIES WERE \$349 MILLION. A MAJOR PORTION OF THE DECLINE FROM THE PEAK LEVEL WAS ATTRIBUTABLE TO INVENTORY WRITEDOWNS OF \$91 MILLION WHICH WERE TAKEN PRIMARILY IN JUNE AND DECEMBER. DUE TO A COMBINATION OF CONTROLLED PURCHASING AND STRONG SALES IN THE DECEMBER QUARTER, TOTAL INVENTORIES WERE \$225 MILLION AT DECEMBER 1985, A 50% REDUCTION FROM THE PRIOR YEAR END. IT IS ANTICIPATED THAT THE INVENTORY TURNS WILL AVERAGE 3.5 IN 1986. ALTHOUGH IT IS COMMODORE'S GOAL TO MAINTAIN 3-4 MONTHS INVENTORY ON HAND, FLUCTUATIONS AND TIMING OF CONSUMER DEMAND CAN CAUSE DEVIATIONS FROM THIS POLICY. FOR EXAMPLE, DUE TO THE LONGER THAN

EXPECTED TIME REQUIRED TO DEVELOP AMIGA SOFTWARE, IT HAS BECOME NECESSARY TO FINE TUNE A TEMPORARY EXCESS SUPPLY SITUATION. THE REQUIRED 90 DAY NOTICE HAS BEEN GIVEN TO REDUCE THE MINIMUM AMIGA PURCHASE COMMITMENT FROM 15,000 PER MONTH TO 10,000 PER MONTH. QUICKER ADJUSTMENTS CAN BE MADE TO ITEMS PRODUCED IN-HOUSE, SUCH AS THE C64.

AVERAGE PAYABLES HAVE DECREASED FROM \$189 MILLION IN 1984 TO \$132 MILLION IN 1985. FAR EAST VENDORS HAVE BEEN A MAJOR SOURCE OF CREDIT FOR THE COMPANY FOR SEVERAL YEARS. IN LATE 1984, AS THE MAJOR INVENTORY BUILDUP WAS TAKING PLACE, CREDIT FROM JAPANESE VENDORS REACHED A PEAK OF \$125 MILLION, GENERALLY UNDER 90 DAY PROMISSORY NOTES. DUE TO ANXIETY OVER THE COMPANY'S FINANCIAL CONDITION AND CHRONIC UNFAVORABLE PUBLICITY IN THE PRESS, JAPANESE SUPPLIERS HAVE REDUCED THEIR WILLINGNESS TO ACCEPT 90 DAY PROMISSORY NOTES. THE AMIGA PURCHASES ARE CURRENTLY MADE UNDER 60 DAY LETTERS OF CREDIT.

IN 1986, FAR EAST VENDORS ARE EXPECTED TO ACCOUNT FOR 40% OR \$60 MILLION, OF TOTAL TRADE CREDIT. OUTSIDE THE FAR EAST, THE MAJOR PAYABLES RELATE TO LOCAL ASSEMBLY MATERIAL SUCH AS CASE WORK, FREIGHT AND DUTIES, PAYROLL AND RELATED BENEFITS AND OPERATING EXPENSES. MOST OF THESE ARE RELATIVELY SMALL SUPPLIERS WHO ARE SUSCEPTIBLE TO BEING INFLUENCED BY UNFAVORABLE PRESS.

THE AGING DATA INDICATES THAT THE QUALITY OF THE ACCOUNTS RECEIVABLE REMAINED SUBSTANTIALLY THE SAME IN 1984 AND 1985. IN THE U.S., 50% OF SALES ARE MADE TO MASS MERCHANDISERS, WHO GENERALLY PAY THEIR BALANCES WITHIN THE ALLOWABLE CREDIT TERMS. THE ONE PROBLEM WITH THESE ACCOUNTS IS THAT PRODUCT

RETURNS ARE HIGH. IN 1985, THE COMPANY ARRANGED FOR NATIONWIDE INDEPENDENT SERVICE CENTERS WHERE DEFECTIVE PRODUCTS COULD BE RETURNED FOR REPAIRS. COMMODORE THEN ATTEMPTED TO INSTITUTE A POLICY TO LIMIT RETURNS FROM THESE MASS MERCHANDISERS, BUT THE LARGE RETAILERS HAVE ONLY RECENTLY STARTED TO ACCEPT THIS POLICY. A MONTHLY PROVISION IS MADE FOR ESTIMATED RETURNS BASED ON EXPERIENCE, AND BOTH SALES AND ACCOUNTS RECEIVABLE ARE REDUCED BY THIS RESERVE FOR RETURNS. CURRENTLY, THE U.S. RETURNS RATE IS SLIGHTLY BELOW 10%, ALTHOUGH IT HAD BEEN AS HIGH AS 20% IN EARLY 1985. ONLY A SMALL PORTION OF THE RETURNS REPRESENT ACTUAL QUALITY PROBLEMS. IN 1986, RETURNS ARE EXPECTED TO BE MUCH LESS SIGNIFICANT DUE TO THE HIGH QUALITY STANDARDS FOR THE AMIGA AND THE ACCEPTANCE BY THE MAJOR RETAILERS OF OUR NEW RETURN POLICY.

IN 1984 AND 1985, THE U.S. HAD \$5-6 MILLION OF BAD DEBTS, INCLUDING DISPUTED ITEMS WITH THE NATIONAL ACCOUNTS. CREDIT AND COLLECTION PROCEDURES WERE STRENGTHENED IN 1985 AND IT IS ANTICIPATED THAT BAD DEBTS WILL BE REDUCED IN 1986. IN GERMANY, RECEIVABLE QUALITY IS EXCELLENT AND BAD DEBTS HAVE BEEN ALMOST NEGLIGIBLE. IN ITALY, THERE WAS A MAJOR PROBLEM IN EARLY 1985 DUE TO A LARGE AMOUNT OF EXTENDED CREDIT TO A FEW MAJOR CUSTOMERS, BUT BY THE END OF 1985, A LARGE AMOUNT OF THESE PAST DUE BALANCES HAD BEEN COLLECTED. IN THE U.K., IT IS ANTICIPATED THAT THE AGING OF RECEIVABLES WILL BE IMPROVED BY THE END OF 1986.

THE QUALITY OF INVENTORY ALSO IMPROVED IN 1985. AT THE BEGINNING OF THE YEAR, THERE WAS \$125 MILLION OF TED AND OTHER PRODUCTS WHICH WERE SUBSEQUENTLY DISCONTINUED. A LARGE PORTION OF THIS INVENTORY WAS LIQUIDATED IN 1985 AND SUBSTANTIAL WRITEDOWNS WERE TAKEN. BY THE END OF THE YEAR, DISCONTINUED

PRODUCTS INVENTORY REPRESENTED 10% OF TOTAL INVENTORY. C64 PRODUCTS NOW CONSTITUTE 45% OF INVENTORY AND NEW PRODUCTS, NAMELY C128, PC10/20 AND AMIGA ACCOUNT FOR FOR REMAINING 45%. WITH THE MANUFACTURE OF SEMICONDUCTORS IN-HOUSE, THE ASSEMBLY OF PRINTED CIRCUIT BOARDS IN THE FAR EAST AND FINAL ASSEMBLY OF FINISHED PRODUCTS IN WEST CHESTER AND BRAUNSCHWEIG, APPROXIMATELY 50% OF THE TOTAL INVENTORY CONTINUES TO BE RAW MATERIALS AND WORK IN PROCESS.

DURING THE PAST TWO YEARS, THE CHRISTMAS SELLING SEASON HAS ASSUMED GREATER IMPORTANCE FOR COMMODORE. ACCORDINGLY, THERE IS A SEASONAL INCREASE IN INVENTORIES IN THE SEPTEMBER QUARTER WITH A CORRESPONDING DECREASE IN THE DECEMBER QUARTER. LIKewise, RECEIVABLES INCREASE IN THE DECEMBER QUARTER BUT NOT IN PROPORTION TO THE SALES INCREASE BECAUSE A LARGER PERCENTAGE OF SALES OCCUR IN THE FIRST TWO MONTHS OF THE QUARTER AND CUSTOMER LIQUIDITY IS HIGHEST AT THIS POINT. IN THE EARLIER QUARTERS, A LARGE AMOUNT OF SALES OCCUR IN THE LAST MONTH OF EACH QUARTER. THE CHANGE IN QUARTERLY PAYABLES GENERALLY FOLLOWS THE INVENTORY LEVELS.

Asset Cover

- Existing - 150% of Debt
- Proposed - Cash + 80% Receivables
+25% Inventory

ASSET COVER

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COMMODORE'S OPERATING ENTITIES IN THE U.S., U.K. AND GERMANY ARE CURRENTLY SUBJECT TO A MINIMUM ASSET COVER COVENANT, WHICH REQUIRES THAT ASSET COVER (DEFINED AS CASH, ACCOUNTS RECEIVABLE AND INVENTORY) MUST BE MAINTAINED AT A LEVEL EQUAL TO 150% OF DEBT. A COROLLARY RESTRICTION UNDER THIS COVENANT REQUIRES THAT INVENTORY CANNOT EXCEED 25% OF TOTAL ASSET COVER. THIS COVENANT IS BEING COMPLIED WITH IN THE U.S. AND GERMANY BUT IS PRESENTLY NOT BEING MET BY THE U.K. SUBSIDIARY. HOWEVER, ON A POOLED BASIS, THE COMBINED ASSET COVER OF THE THREE OPERATING SUBSIDIARIES WOULD MEET THE 150% ASSET COVER TEST BOTH AS OF YEAR-END 1985, AND PROSPECTIVELY ON A QUARTERLY BASIS DURING 1986.

FOR THE U.S. SUBSIDIARY, A SHIFT FROM LOCAL OR STAND ALONE ASSET COVER TO A POOLED BASIS WOULD RESULT IN A SMALL DECLINE IN COVERAGE BUT IT WOULD CONTINUE TO SUBSTANTIALLY EXCEED THE 150% LEVEL ON BOTH BASES.

WHILE AN ASSET COVER COVENANT WAS NOT FORMALLY INCORPORATED AS A CONDITION TO THE WAIVER FROM THE GERMAN BANKS, IT WAS AGREED THAT THE GERMAN SUBSIDIARIES WOULD COMPLY WITH THE 150% ASSET COVER TEST ON A BEST EFFORTS BASIS. SINCE GERMAN FACILITIES EXCEED THE CURRENT OUTSTANDING LOANS, ASSET COVER FOR THE GERMAN FACILITIES ON A POOLED BASIS IS ESSENTIALLY IN LINE WITH THE LOCAL BASIS, AND WOULD SUBSTANTIALLY EXCEED 150%.

AS NOTED PREVIOUSLY, THE U.K. SUBSIDIARY IS NOT COMPLYING WITH THE 150% TEST, AND THE 1986 FORECAST SHOWS A CONTINUING DETERIORATION IN ASSET COVERAGE TO 115% BY YEAR END. HOWEVER, ON A POOLED BASIS, THE U.K. SUBSIDIARY WOULD BE ABLE TO COMPLY WITH THE 150% REQUIREMENT.

Asset Cover - Germany

\$ In Millions	Forecast			
	<u>12/85</u>	<u>3/86</u>	<u>6/86</u>	<u>9/86</u> <u>12/86</u>
Debt	\$13	\$16	\$16	\$16 \$15
Local Asset Cover	27	26	29	34 35
Pooled Asset Cover	18	21	21	23 24

Asset Cover - United Kingdom

	Forecast				
\$ In Millions	<u>12/85</u>	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>
Debt	\$23	\$18	\$18	\$18	\$15
Local Asset Cover	30	20	15	15	16
Pooled Asset Cover	33	22	22	24	24

Asset Cover - United States

		Forecast			
\$ In Millions	<u>12/85</u>	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>
Debt	\$ 81	\$77	\$77	\$ 77	\$ 66
Local Asset Cover	106	93	96	104	103
Pooled Asset Cover	112	96	97	106	106

Pooled Asset Cover

		Forecast			
\$ In Millions	<u>12/85</u>	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>
Pooled Debt	\$117	\$111	\$111	\$111	\$ 96
Pooled Asset Cover	163	139	140	153	154
Excess Asset Cover	46	28	29	42	58

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ALTHOUGH THE CURRENT ASSET COVER TEST COULD BE MET ON A POOLED BASIS, IT IS UNREASONABLY RESTRICTIVE WITH REGARD TO THE PERCENT OF ALLOWABLE INVENTORY. IT IS PROPOSED THAT THE ASSET COVER TEST BE CHANGED TO INCLUDE CASH, 80% OF NET RECEIVABLES AND 25% OF INVENTORY. ON THIS BASIS, U.S. AND GERMANY WOULD BE IN COMPLIANCE ON A LOCAL BASIS, BUT THE U.K. COULD NOT MEET THIS TEST AFTER MID-1986 WHEN THE RAW MATERIAL INVENTORY HAS BEEN TRANSFERRED FROM THE CORBY MANUFACTURING PLANT TO BRAUNSCHWEIG, GERMANY.

ON A POOLED BASIS, ALL THREE SUBSIDIARIES WOULD BE IN COMPLIANCE WITH THE PROPOSED ASSET COVER FORMULA. FOR THE FIRST HALF OF 1986 THE EXCESS ASSET COVER UNDER THE POOLED BASIS IS EXPECTED TO BE ALMOST \$30 MILLION WITH A DOUBLING BY THE END OF 1986.

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IN THE U.S. POOLED COVER WOULD BE IN LINE WITH LOCAL COVER, WHICH IS APPROXIMATELY \$20 MILLION OF EXCESS ASSET COVER ON BOTH BASES.

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IN THE U.K. LOCAL ASSET COVER IS PROJECTED TO DECREASE SIGNIFICANTLY FROM \$30 MILLION AT DECEMBER 1985 TO \$15 MILLION IN JUNE 1986, BELOW THE LEVEL OF BANK DEBT. HOWEVER, UNDER THE POOLED ASSET FORMULA, THERE WOULD BE SUFFICIENT COVER FOR THE U.K. THROUGHOUT 1986.

- SLIDE RIGHT -

AT DECEMBER 1985, GERMANY'S LOCAL ASSET COVER WAS DOUBLE THE DEBT OF \$13 MILLION. UNDER THE POOLED ASSET COVER FORMULA, THE EXCESS COVER WOULD INITIALLY AMOUNT TO \$5 MILLION, INCREASING TO \$9 MILLION BY YEAR END.

Financial Ratios

	<u>Debt to Total Capital</u>	<u>Cash Flow/ Total Debt</u>	<u>Interest Coverage</u>
1984	38%	60%	7.3X
1985	63%	-	-
1986	54%	29%	2.5X

CAPITAL STRUCTURE & FINANCING ALTERNATIVES

IN THE OPINION OF DILLON READ, COMMODORE'S CAPACITY TO RAISE ADDITIONAL FUNDS IS PRESENTLY VERY LIMITED. THIS IS PRIMARILY DUE TO THE COMPANY'S RECENT LOSSES AND THE ASSOCIATED PROBLEMS OF PAST CREDIBILITY AND FUTURE MARKET UNCERTAINTY.

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HOWEVER, THE 1986 FORECAST SHOWS THAT THE COMPANY'S FINANCIAL RATIOS SHOULD BEGIN TO IMPROVE DRAMATICALLY. FOLLOWING THE DOWNTURN OF 1985, THE COMPANY FORECASTS A DEBT TO TOTAL CAPITAL RATIO OF 54% BY YEAR-END 1986, REFLECTING THE COMPANY'S RETURN TO PROFITABILITY AND ITS ABILITY TO REPAY APPROXIMATELY \$27 MILLION OF CURRENT BANK DEBT USING INTERNALLY GENERATED CASH FLOW. THE 1986 FORECAST ALSO INDICATES A CASH FLOW TO TOTAL DEBT RATIO OF 29% AND AN IMPROVED INTEREST COVERAGE RATIO OF 2.5 TIMES.

Financing Alternatives

- Issuance of New Equity
 - Option Not Currently Attractive
 - Initiate Only After Substantial Evidence of “Turnaround”
 - Must Re-Establish Credibility and Regain Security Analysts’ Support

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IN THIS REGARD, DILLON READ HAS ADVISED THAT SEVERAL OPTIONS COULD DEVELOP ONCE A TURNAROUND APPEARS TO BE UNDERWAY. THE OFFERING OF ADDITIONAL EQUITY IS AT THE CURRENT TIME, NOT A VIABLE OPTION. TO SUCCESSFULLY COMPLETE A COMMON STOCK OFFERING, COMMODORE MUST FIRST REESTABLISH ITS VIABILITY IN THE MARKETPLACE, PARTICULARLY WITH THE SECURITY ANALYSTS. THERE MUST BE "CONCRETE" EVIDENCE THAT A TURNAROUND IS UNDER WAY AND SUSTAINABLE. IN ADDITION, THE TIMING OF ANY EQUITY OFFERING MUST BE CAREFULLY TAILORED TO MARKET CONDITIONS, I.E., ECONOMIC CONDITIONS, INDUSTRY OUTLOOK, COMPETITORS' PERFORMANCE, ETC.

THE OPPORTUNITY TO ISSUE NEW EQUITY WILL BE KEPT UNDER CONTINUAL REVIEW WITH DILLON READ ON AN ONGOING BASIS. AS A FIRST STEP TOWARD IMPROVING THE MARKET'S PERCEPTION OF THE COMPANY, A MEETING WITH THE APPROPRIATE SECURITY ANALYSTS WILL BE INITIATED TO EDUCATE THE PUBLIC ABOUT COMMODORE'S PLANS AND PROSPECTS FOR THE FUTURE.

Financing Alternatives

- Issuance of New Equity
 - Option Not Currently Attractive
 - Initiate Only After Substantial Evidence of “Turnaround”
 - Must Re-Establish Credibility and Regain Security Analysts’ Support
- Issuance of Public Debt
 - “High Yield” Public Market Is Only Viable Near-Term Option
 - Could Be Source of Financing After the Restoration of Profitability by End of Second Quarter
 - Reinstatement of Bank Credit Agreement Critical Precondition for Public Financing

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AN ADDITIONAL SOURCE OF FUNDS FOR COMMODORE COULD BE THE PUBLIC "HIGH YIELD" MARKET, DILLON READ HAS ADVISED THAT THIS SOURCE COULD BE ACCESSED, POSSIBLY AS SOON AS THE SECOND OR THIRD CALENDAR QUARTER, PROVIDED THAT PROFITABILITY HAS BEEN RESTORED. THIS TIME SCHEDULE WOULD ALLOW THE MARKET TO FULLY ABSORB THE 1985 CALENDAR RESULTS. MORE IMPORTANTLY, IT PRESUMES THE NEGOTIATION AND ESTABLISHMENT OF A NEW CREDIT AGREEMENT WITHOUT WHICH PUBLIC FINANCING WOULD BE ELUSIVE, AND SUPPLIER CREDIT WOULD BE THREATENED. FURTHER, IT WOULD ENABLE THE COMPANY TO GAIN CREDIBILITY BY A RESTORATION OF PROFITABILITY AND AN IMPROVED DIALOGUE WITH THE INVESTMENT COMMUNITY. FINALLY, IT IS ENVISIONED THAT ANY OFFERING OF EQUITY OR PUBLIC DEBT WOULD BE USED TO BOTH ENHANCE THE COMPANY'S FINANCIAL FLEXIBILITY AND REPAY BANK DEBT.

CREDIT REQUEST

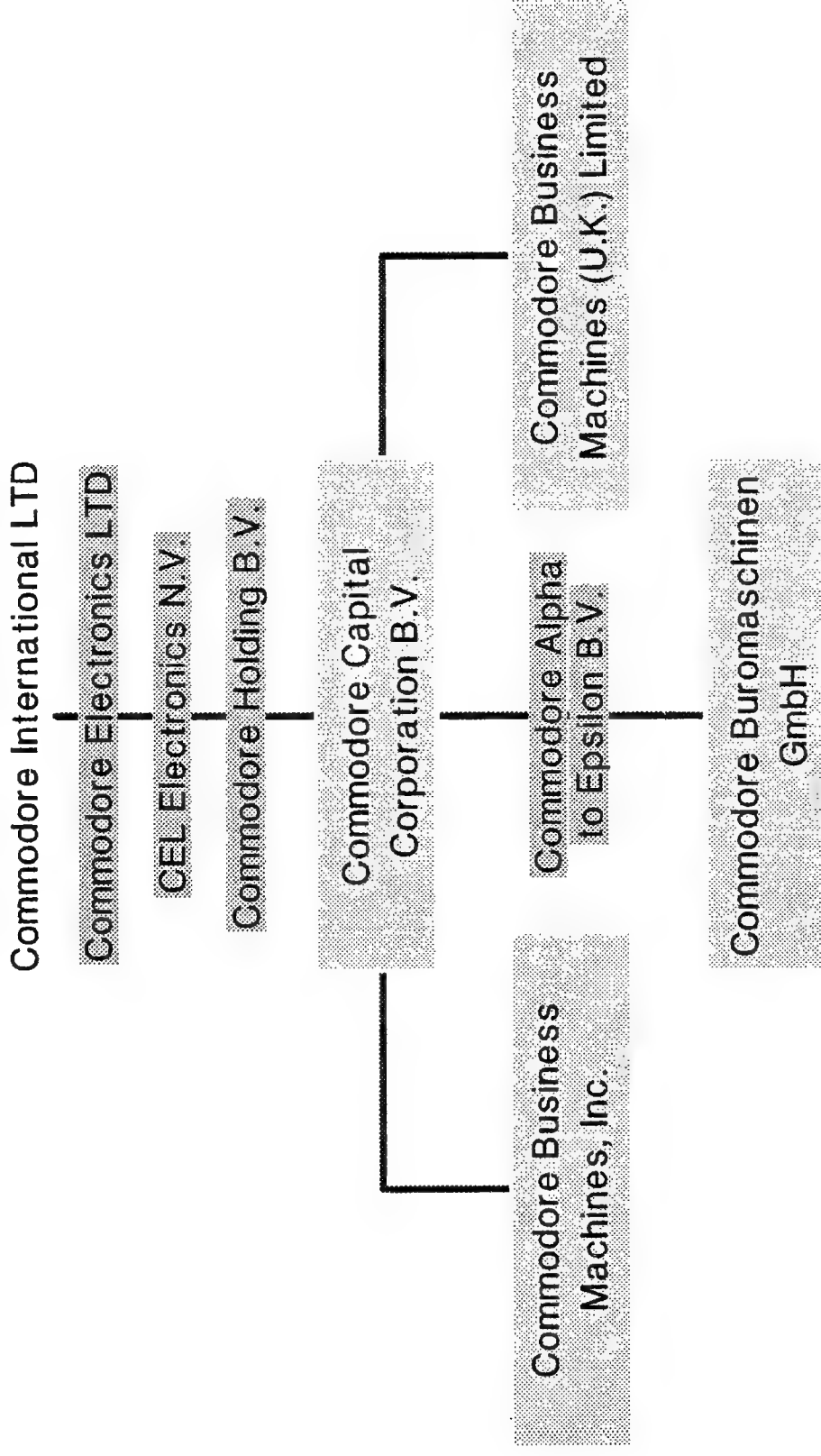
WE HAVE REVIEWED OUR CALENDAR 1986 FINANCIAL FORECAST TODAY IN ORDER TO FACILITATE A RESTRUCTURING OF OUR CREDIT FACILITIES IN THE U.S., U.K., AND GERMANY. A NORMALIZATION OF THE COMPANY'S CREDIT ARRANGEMENTS WITH ITS PRINCIPAL BANKS WOULD HELP PUT AN END TO THE CHRONIC RUMORS ABOUT COMMODORE'S IMMINENT FAILURE, WHICH IS INCREASINGLY ASSOCIATED WITH OUR "DEFAULT" OR "NON-COMPLIANCE" BORROWING STATUS.

IN THIS REGARD, THE ESTABLISHMENT OF A NEW ONE YEAR CREDIT AGREEMENT WITH YOUR INSTITUTIONS WOULD ENABLE THE COMPANY TO ACHIEVE CERTAIN IMPORTANT OBJECTIVES, INCLUDING THE MAINTENANCE OF FACILITIES WITH LOCAL BANKS, RESTORING CONSUMER CONFIDENCE IN THE COMPANY'S FUTURE PRESENCE IN THE MARKET PLACE, AND ALLEVIATING THE CHRONIC ANXIETY OF SUPPLIERS MANIFESTED IN SHORTENED PAYMENT TERMS. INDEED, DUE TO A RECENT WALL STREET JOURNAL ARTICLE, THE COMPANY IS CURRENTLY FACING INTENSE PRESSURE FROM JAPANESE SUPPLIERS REQUESTING C.O.D OR CONSIDERABLY REDUCED PAYMENT TERMS. WE HAVE ALSO EXPERIENCED DELAYS IN COLLECTIONS FROM CERTAIN MAJOR RETAILERS.

FURTHERMORE, A NEW CREDIT AGREEMENT WOULD ENABLE MANAGEMENT TO DEVOTE ITS EFFORTS MORE FULLY TO MANAGING THE BUSINESS AND IMPLEMENTING VARIOUS PROGRAMS VITAL TO FUTURE PROFITABILITY. THE COMPANY'S STAFF RESOURCES ARE VERY LEAN AND A DISPROPORTIONATE ALLOCATION OF RESOURCES TO CONTINUOUS WAIVER RENEGOTIATIONS IS NOT IN THE BEST INTEREST OF THE COMPANY OR ITS LENDERS.

Corporate Structure

Proposed Borrowing Entity



Credit Request

- Borrower

- Commodore Capital Corporation (CCC)

- SLIDE LEFT -

- SLIDE RIGHT -

IN CONJUNCTION WITH NEGOTIATING A NEW CREDIT AGREEMENT, COMMODORE PLANS TO ESTABLISH A NEW BORROWING ENTITY, COMMODORE CAPITAL CORPORATION, TO BE INCORPORATED IN THE NETHERLANDS. AS DETAILED ON THIS CHART, COMMODORE CAPITAL WILL BE AN INDIRECT SUBSIDIARY OF COMMODORE INTERNATIONAL LIMITED, COMMODORE ELECTRONICS LIMITED, AND COMMODORE ELECTRONICS N.V., AND A DIRECT SUBSIDIARY OF COMMODORE HOLDING B.V. COMMODORE CAPITAL WOULD ALSO BECOME THE PARENT OF THE OPERATING SUBSIDIARIES IN THE U.S., U.K., AND GERMANY. THE GERMAN COMPANY WOULD CONTINUE TO BE OWNED THROUGH A GROUP OF EXISTING HOLDING COMPANIES.

Pooled Credit Facility

In Millions	<u>Local Currency</u>	<u>Dollar Equivalent</u>
United States	\$ 77	\$ 77
United Kingdom	£ 12	18
Germany	DM 55	22
Total		<u>22</u> \$117

Credit Request

- Borrower

- Commodore Capital Corporation (CCC)

- Facility

- \$ 117 Million One Year Unsecured Revolving
Commitment Maturing March 15, 1987

- SLIDE LEFT -

- SLIDE RIGHT -

THROUGH THIS STRUCTURE, IT IS CONTEMPLATED THAT COMMODORE'S CURRENT FACILITIES IN THE U.S., U.K., AND GERMANY WILL BE CONSOLIDATED INTO A POOLED CREDIT FACILITY FOR COMMODORE CAPITAL.

MORE SPECIFICALLY, THE CURRENT OUTSTANDING LOANS OF \$77 MILLION IN THE U.S., \$18 MILLION IN THE U.K. AND FACILITIES OF UP TO \$22 MILLION IN GERMANY WOULD BE CONSOLIDATED INTO A \$117 MILLION ONE YEAR UNSECURED REVOLVING COMMITMENT MATURING MARCH 15, 1987. THIS FACILITY WOULD BE COMPRISED OF THREE UNDERLYING CURRENCY COMPONENTS; 77 MILLION U.S. DOLLARS; 12 MILLION STERLING AND 55 MILLION DEUTSCH MARKS.

IT IS CONTEMPLATED THAT THE FACILITY WOULD BE REDUCED ON A PRO RATA BASIS TO \$102 MILLION BY YEAR-END 1986. USAGE UNDER THE FACILITY IN LOCAL CURRENCY WOULD BE AVAILABLE ON A NORMAL REVOLVING BASIS WITH LOCAL COMPANIES BORROWING FROM COMMODORE CAPITAL WHICH IN TURN WOULD BORROW AN EQUIVALENT AMOUNT FROM THE POOLED BANK GROUP. IT IS ALSO CONTEMPLATED THAT ANY EXCESS CASH WILL BE UTILIZED BY THE LOCAL SUBSIDIARIES TO REDUCE DEBT TO COMMODORE CAPITAL, WHICH IN TURN WOULD MAKE TEMPORARY PRO-RATA REDUCTIONS IN OUTSTANDING DEBT UNDER THE REVOLVER. THIS OPERATING PROCEDURE WILL PRECLUDE THE MAINTENANCE OF CASH BALANCES WITH NON-CREDITOR BANKS, AND SHOULD GREATLY HELP ESTABLISH MUTUAL TRUST.

ADDITIONALLY, IT IS PROPOSED THAT THE HONG KONG LENDERS MAINTAIN THEIR CURRENT \$13 MILLION OUTSTANDING UNDER VARIOUS CREDIT LINES. THESE OUTSTANDING BALANCES WOULD ALSO BE REDUCED ON A PRO RATA BASIS TO \$11 MILLION BY YEAR END, CONSISTENT WITH THE POOLED BANK GROUP.

Credit Request

- Borrower
 - Commodore Capital Corporation (CCC)
- Facility
 - \$117 Million One Year Unsecured Revolving Commitment Maturing March 15, 1987
- Guarantors
 - Commodore Business Machines, Inc.
 - Commodore Business Machines (UK) Limited
 - Commodore Bueromaschinen GmbH
 - Commodore International Limited
 - Commodore Electronics Limited
 - Other Holding Companies
- Covenants
 - CCC and Operating Subsidiaries
 - Maintenance of Consolidated Asset Cover
 - Negative Pledge on Assets and Debt
 - Minimum Consolidated Net Worth
 - Other Appropriate Covenants

Credit Request

- Borrower

- Commodore Capital Corporation (CCC)

- Facility

- \$117 Million One Year Unsecured Revolving Commitment Maturing March 15, 1987

- Guarantors

- Commodore Business Machines, Inc.
Commodore Business Machines (UK) Limited
Commodore Bueromaschinen GmbH
Commodore International Limited
Commodore Electronics Limited
Other Holding Companies

Pooled Asset Cover

CCC and Subsidiaries

	Forecast				
	<u>12/85</u>	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>
\$ in Millions					
Pooled Debt	\$117	\$111	\$111	\$111	\$ 96
Pooled Asset Cover	163	139	140	153	154

- SLIDE LEFT -

ADDITIONALLY, IT IS PROPOSED THAT EACH OPERATING SUBSIDIARY WILL GUARANTEE COMMODORE CAPITAL DEBT.

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AS DETAILED PREVIOUSLY, COMMODORE CAPITAL AND ITS CONSOLIDATED SUBSIDIARIES WOULD AGREE TO MAINTAIN A REQUIRED LEVEL OF ASSET COVER. IT IS PROPOSED THAT THE CURRENT ASSET COVER TEST OF 150% BE REPLACED WITH A NEW ASSET COVER FORMULA. THIS FORMULA WOULD REQUIRE THAT THE POOLED ASSET COVER MUST ALWAYS BE GREATER THAN POOLED BANK DEBT, AND MUST BE MAINTAINED AT A LEVEL EQUAL TO THE SUM OF CASH, 80% OF ELIGIBLE ACCOUNTS RECEIVABLE AND 25% OF INVENTORY. AS SHOWN ON THIS CHART, COMPLIANCE WITH ASSET COVER COULD BE ACHIEVED CONSISTENT WITH MAINTAINING, ON THIS BASIS, REASONABLE OPERATING FLEXIBILITY.

EACH OPERATING SUBSIDIARY WILL ALSO PROVIDE THE BANK GROUP NEGATIVE PLEDGE COVENANTS ON ASSETS AND RESTRICTIONS ON DEBT. FINALLY, IT IS CONTEMPLATED THAT COMMODORE CAPITAL AND THE SUBSIDIARIES WILL MAINTAIN A MINIMUM CONSOLIDATED NET WORTH TO BE MUTUALLY AGREED.

Covenants of Guarantor

CIL

<u>Proposed Ratios</u>	<u>12/85</u>	<u>3/86</u>	<u>6/86</u>	<u>9/86</u>	<u>12/86</u>	<u>Thereafter</u>
Liabilities/ Tangible						
Net Worth	4.75	4.50	4.25	4.25	3.50	3.50
Minimum Tangible Net						
Worth (\$MM)	\$ 90	\$ 90	\$ 90	\$ 90	\$ 120	\$ 126

Credit Request

- Borrower
 - Commodore Capital Corporation (CCC)
- Facility
 - \$117 Million One Year Unsecured Revolving Commitment Maturing March 15, 1987
- Guarantors
 - Commodore Business Machines, Inc.
 - Commodore Business Machines (UK) Limited
 - Commodore Bueromaschinen GmbH
 - Commodore International Limited
 - Commodore Electronics Limited
 - Other Holding Companies
- Covenants
 - CCC and Operating Subsidiaries
 - Maintenance of Consolidated Asset Cover
 - Negative Pledge on Assets and Debt
 - Minimum Consolidated Net Worth
 - Other Appropriate Covenants
 - CIL
 - Senior Liabilities to Tangible Net Worth Ratio
 - Minimum Tangible Net Worth

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CONSISTENT WITH CURRENT PRACTICE, CIL AND OTHER HOLDING COMPANIES WILL ALSO CONTINUE TO GUARANTEE COMMODORE CAPITAL DEBT. IT IS ALSO ENVISIONED THAT, BASED ON THE 1986 FORECAST, CIL WILL MAINTAIN A MINIMUM CONSOLIDATED TANGIBLE NET WORTH INCREASING FROM \$90 TO \$120 MILLION BY YEAR END AND A CONSOLIDATED SENIOR LIABILITIES TO CONSOLIDATED TANGIBLE NET WORTH RATIO, COMMENCING AT 4.75 AND DECLINING TO 3.5 BY YEAR END.

Financial Reporting Covenant

- CIL, CCC, U.S.,
U.K., and GmbH
 - Quarterly
 - Income Statement
 - Balance Sheet
 - Accounts Receivable Aging
 - Changes in Financial Position
 - Covenant Compliance Schedule
- Price Waterhouse
 - Quarterly Reviews

Credit Request

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- Covenants
 - CCC and Operating
 - Maintenance of Consolidated Asset Cover
 - Negative Pledge on Assets and Debt
 - Minimum Consolidated Net Worth
 - Other Appropriate Covenants
 - CIL
 - Senior Liabilities to Tangible Net Worth Ratio
 - Minimum Tangible Net Worth
 - Additional Covenants
 - Quarterly Financial Reporting
 - Price Waterhouse Reviews

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WITH REGARD TO FUTURE REPORTING REQUIREMENTS, IT IS PROPOSED THAT COMPREHENSIVE FINANCIAL PACKAGES AND A COVENANT COMPLIANCE REPORT WILL BE PROVIDED ON A QUARTERLY BASIS.

FINALLY, WE WOULD FULLY SUPPORT THE CONTINUATION OF A PRICE WATERHOUSE REVIEW ON A QUARTERLY BASIS.

NOW MARSHALL SMITH WILL MAKE A FEW CONCLUDING REMARKS.

CONCLUDING REMARKS

LADIES AND GENTLEMEN:

IT IS IMPERATIVE THAT WE CONCLUDE A NEW CREDIT AGREEMENT AS SOON AS POSSIBLE. WE CANNOT AFFORD ANY FURTHER UNFAVORABLE PUBLICITY SUCH AS THE ARTICLE IN THE WALL STREET JOURNAL ON JANUARY 31, 1986 WHICH INDICATED THAT WE WERE HAVING PROBLEMS MEETING OUR BANK OBLIGATIONS AND ON THE VERGE OF POSSIBLE BANKRUPTCY. AS A RESULT OF THIS EXTREMELY NEGATIVE PRESS, WHICH WAS RECENTLY REPEATED IN THE ASIAN WALL STREET JOURNAL, MANY OF OUR JAPANESE SUPPLIERS HAVE DEMANDED SHORTER CREDIT TERMS AND SOME ARE EVEN REQUESTING C.O.D. I AM LEAVING FOR TOKYO TOMORROW TO MEET WITH OUR SUPPLIERS TO REVIEW OUR CURRENT AND PROSPECTIVE FINANCIAL POSITION AND INFORM THEM THAT WE ARE CONFIDENT THAT WE WILL CONCLUDE A NEW ONE-YEAR CREDIT AGREEMENT BEFORE THE END OF THE MONTH. ANY DELAY IN REACHING A NEW AGREEMENT WOULD ALSO BE EXTREMELY DESTABILIZING TO OUR RETAIL CUSTOMERS AND AMIGA DEALERS, WHO ARE FEARFUL OF CARRYING THE PRODUCT OF A COMPANY WHICH MAY HAVE A SHORT LIFE SPAN. WE ARE ALREADY EXPERIENCING DELAYS IN OUR COLLECTIONS FROM CERTAIN RETAIL CHAINS. THE UNCERTAINTY REGARDING OUR BANK RELATIONSHIPS MUST BE RESOLVED EXPEDITIOUSLY.

WE WOULD LIKE TO CONVENE A FOLLOW-UP MEETING OF THE WORLDWIDE BANK GROUP IN NEW YORK DURING THE WEEK OF FEBRUARY 17 WITH A VIEW REACHING AN AGREEMENT IN PRINCIPLE BY THE END OF THAT WEEK. TO PRECLUDE ANY FURTHER UNFAVORABLE PRESS RESULTING FROM WAIVERS AND THE ASSOCIATED CONSEQUENCES THEREOF, WE MUST ALL WORK TOGETHER SO THAT WE CAN ANNOUNCE AN AGREEMENT IN PRINCIPLE AS SOON AS POSSIBLE.

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